EB-2007-0598

IN THE MATTER OF the *Ontario Energy Board Act 1998*, S.O. 1998, c.15 (Schedule B);

AND IN THE MATTER OF an Application by Union Gas Limited for an order or orders amending or varying the rate or rates charged to customers as of July 1, 2007.

DOCUMENTS BRIEF

RE: DEFERRED TAXES ISSUES

July 6, 2007

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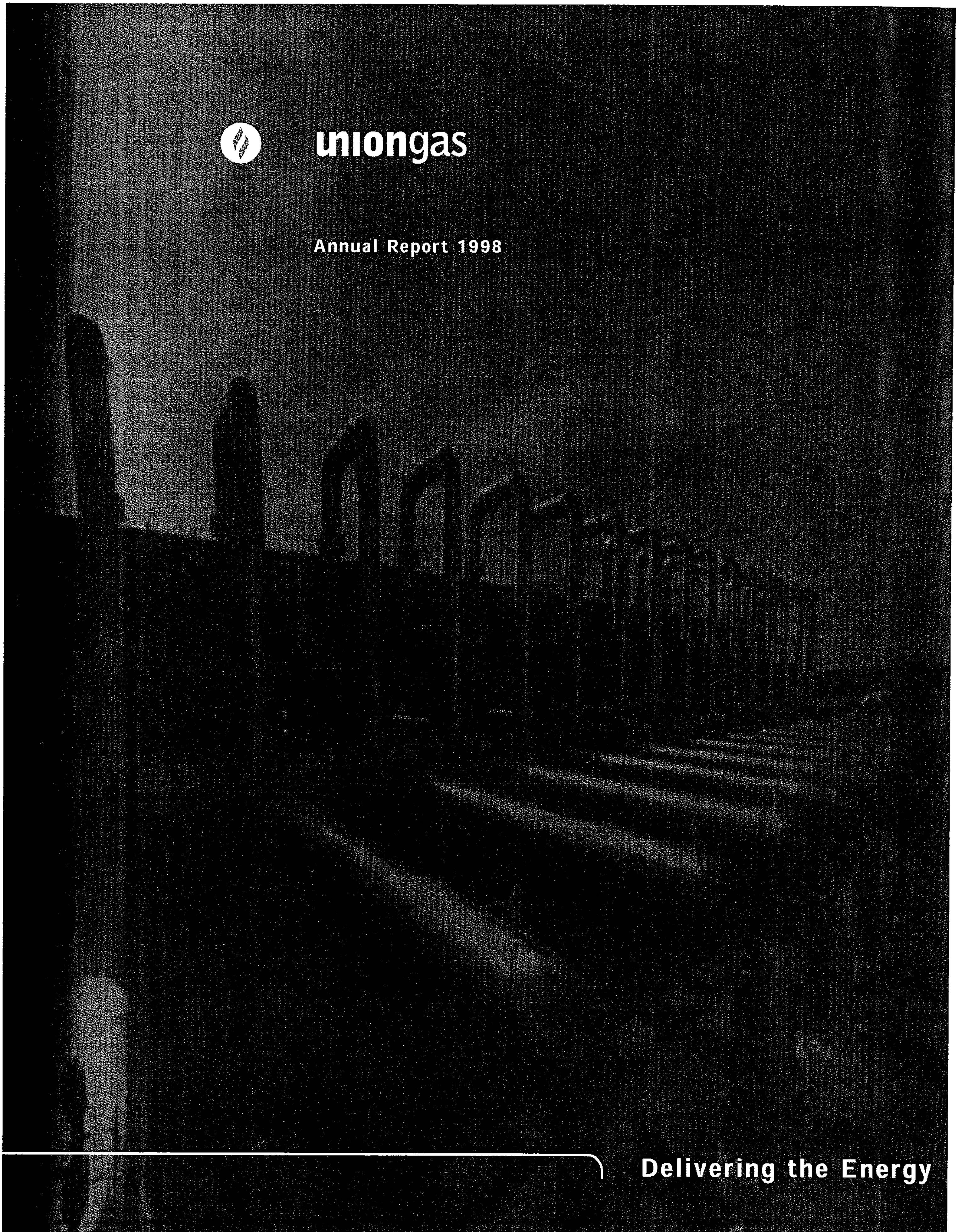
I N D E X

TAB 1


uniongas
Annual Report 1998
Delivering the Energy

Union Gas Limited is a major Canadian natural gas utility which provides energy delivery and related services to more than one million residential, commercial and industrial customers in over 400 communities in northern, southwestern and eastern Ontario. The Company's distribution service area extends across northern Ontario from the Manitoba border to the North Bay/Muskoka area, throughout southern Ontario from Windsor to just west of Toronto, and across eastern Ontario from Port Hope to Cornwall. Union Gas also provides natural gas storage and transportation services for other utilities and energy market participants in Ontario, Quebec and the United States.

Revenue for 1998 was $1.6 billion, net income was $109 million, and assets totalled $4 billion. Total throughput for 1998 was 31.8 billion cubic metres. Union Gas employs about 2,900 people.

The utility operations of Union Gas are regulated under the Ontario Energy Board Act and the Energy Act (Ontario). Union Gas is a wholly-owned subsidiary of Westcoast Energy Inc. of Vancouver, B.C.

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The Company has underway an extensive program of assessment and remediation of computer systems and embedded logic systems in use throughout the Company in an effort to avoid Year 2000 problems which could cause material disruption to the Company's business. The assessment phase of the Year 2000 program was completed in 1998 and the Company is currently carrying out the remediation, testing and implementation phase. The Company's goal is to correct, replace and test all critical systems well before December 31, 1999. The Company's progress to date, and plans for 1999, indicate that the Company is well-positioned to be Year 2000 ready in advance of December 31, 1999.

The effect of the Year 2000 issue on the Company also depends on the Year 2000 readiness of external parties. The Company is in communication with its customers, vital suppliers and other third parties to assess their level of Year 2000 readiness.

It is not possible for the Company to be certain that all aspects of the Year 2000 issue affecting the Company, including those related to efforts of external parties, will be fully resolved. The Company, therefore, is developing business contingency plans to allow it to continue to carry on business in an orderly manner into the year 2000.

The Company projects the cost of its Year 2000 project to be approximately $23.7 million, including $20.0 million in incremental third party operating expenditures and $3.7 million in capital costs. Approximately 24% of these costs have been incurred to December 31, 1998. The OEB has approved recovery of $10.8 million of incremental third party operating costs which includes the recovery of $3.2 million through 1998 deferral account dispositions and the recovery of a further $7.6 million through 1999 rates. As well, the OEB approved $1.5 million of capital costs for inclusion in rate base. The remaining third party operating costs will be recorded in an OEB approved deferral account and will be brought forward to the OEB in the future for final disposition.

Progress against plan is reviewed on an ongoing basis by senior executives of the Company and Westcoast. The status of the Year 2000 program is also reported to the Audit Committee of the Board of Directors.

TRANSFER OF RETAIL MERCHANDISE PROGRAMS

On January 1, 1999, following approval of the OEB, the Company sold its net assets relating to the retail merchandise programs to UEI Holdings Inc. an affiliated, unregulated company. Immediately thereafter, the assets were sold by UEI Holdings Inc. to Union Energy Inc. (Union Energy) and Westcoast Capital Corporation (Westcoast Capital). Union Energy and Westcoast Capital are also affiliated unregulated businesses. The retail merchandise programs include water heater and other equipment rentals, appliance sales and service work, and merchandise financing. In its decision, the OEB held that the transfer was in keeping with the deregulation of the Ontario energy industry.

The transfer of the retail merchandise programs to Union Energy and Westcoast Capital and the related restructuring is in response to the rapidly changing and increasingly competitive energy marketplace in Ontario and throughout North America. The restructuring will allow the Company to concentrate on developing new delivery services and to continue to operate a safe and reliable delivery system to serve customers. Union Energy and Westcoast Capital, as unregulated companies, will have more flexibility than the utility to design and package energy products and services to meet customers' unique needs and expectations.

The proceeds of the sale comprised $343.9 million of cash and $150.0 million of UEI Holdings Inc. 5.2% cumulative redeemable preferred shares. The cash received was applied to reduce short-term borrowings and pay a dividend on common shares of $135.0 million. The amount of the dividend on common shares was determined based on the excess common equity resulting from the reduction in rate base upon the sale of the assets.

The following is a summary of the net assets transferred as part of the transaction:

(millions)		
Rental equipment		$ 405.1
Finance contracts		155.4
Inventory		14.5
General plant and other assets		15.5
		590.5
Deferred income taxes	– recorded	(65.3)
	– unrecorded	(31.3)
		$ 493.9

Since the sale of the assets is a related party transaction, it has been accounted for at the carrying amounts of the net assets transferred. Under this accounting, the difference between the net proceeds received and the carrying amounts was recorded as an adjustment to shareholder's equity. This resulted in a charge to the Company's retained earnings of $35.3 million as at January 1, 1999. The charge to retained earnings represents the unrecorded deferred income taxes on assets sold of $31.3 million and costs of disposition of $4.0 million. The unrecorded deferred income taxes arose through the prior application of the flow through tax accounting methodology.

The forecast average rate base for 1999 as approved by the OEB is $2.71 billion. The reduction compared with the 1998 average rate base of $3.21 billion is due primarily to the sale of the assets related to the retail merchandise programs.

ENVIRONMENTAL MANAGEMENT PROGRAM

The Company is committed to protecting the environment and maintaining public and employee health and safety throughout all phases and locations of operations and construction activities. The Company conducts business in accordance with the principles of sustainable development and environment, health and safety responsibility. The Company integrates environmental, social and economic considerations into the processes of planning, construction and operations to ensure that the environment and human needs are supported both in the present and for future generations.

The Company also considers environmental protection, health and safety to be both corporate and personal responsibilities for all its employees. In support of this, the Company conducted a major initiative in 1998 to provide extensive technical training to employees on a number of environmental issues. In addition, the Company has marketing programs that encourage the efficient use of natural gas by residential, commercial and industrial customers. These programs range from supporting school activities that teach students the benefits of using energy wisely, to providing commercial and industrial customers information on high efficiency boilers.

TAB 2

Ontario
Energy
Board

Ontario

E.B.O. 179-14/15

IN THE MATTER OF APPLICATIONS BY

ENBRIDGE CONSUMERS GAS

FOR

CERTAIN APPROVALS ASSOCIATED WITH THE RETENTION OF ANCILLARY PROGRAMS WITHIN THE UTILITY

DECISION WITH REASONS

1999 MARCH 31

E.B.O. 179-14
E.B.O. 179-15

IN THE MATTER OF the Ontario Energy Board Act, R.S.O. 1990, c. O.13;

AND IN THE MATTER OF an Application by The Consumers' Gas Company Ltd. for an order or orders approving rates to be charged for the sale, distribution, transmission and storage of gas for its 1999 fiscal year;

AND IN THE MATTER OF an Application by The Consumers' Gas Company Ltd. for all necessary approvals of transactions related to the transfer of certain customer information systems to an affiliate;

AND IN THE MATTER OF an Application by The Consumers' Gas Company Ltd. for all necessary approvals of transactions related to the transfer of certain businesses and activities to one or more affiliates;

AND IN THE MATTER OF an Application by The Consumers' Gas Company Ltd. for approval of an incentive mechanism in relation to the Operation and Maintenance Expense component of its cost of service, effective during the 2000 through 2002 fiscal years, and an incentive mechanism in relation to Demand Side Management.

BEFORE: H.G. Morrison
Presiding Member

P. Vlahos
Member

DECISION WITH REASONS

March 31, 1999

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1. INTRODUCTION

1.1 THE APPLICATION AND PROCEEDING

1.1.1 The Consumers' Gas Company Ltd. ("Enbridge Consumers Gas" or "the Company") filed an Application with the Ontario Energy Board ("the Board") dated January 8, 1998 ("the Application"), for relief on a number of matters. The details of the application are contained in the Board's Decision with Reasons in E.B.R.O. 497, issued August 30, 1998. The present Proceeding addresses approvals requested by the Company for transactions between itself and an affiliate and for specific regulatory treatment of certain programs.

1.1.2 The procedural framework for this Proceeding was set out in Procedural Order No. 5 issued in October 1998. As a result of this Order, one Proceeding was constituted for the Company's proposed targeted Performance Based Regulation or PBR (E.B.R.O. 497-01) and another for the matters described in this Decision (E.B.O. 179-14 and E.B.O. 179-15).

1.1.3 Procedural Order No. 5 provided for the oral hearing into this matter to commence on December 16, 1998; Procedural Order No. 6 set dates for a technical conference, a settlement conference and the exchange of interrogatories. The Board was advised on December 15, 1998 by the Minister of Energy, Science and Technology that the Government had approved new Undertakings of the Company to be effective March 31, 1999 ("the 1998 Undertakings" or "the new Undertakings"). The 1998 Undertakings superseded the 1994 Undertakings and will be in effect at the time the proposed transactions would take place. While the 1994 Undertakings had required the Board's approval for affiliate transactions and diversification activities of the type proposed, the new Undertakings removed that requirement. Board approval is therefore no longer required for the transfer of ancillary activities to an affiliate, but Board approval is required to retain such activities within the regulated utility.

1.1.4 At the outset of the hearing of the Application on December 16, 1998, the Board requested the Company and intervenors to make submissions on the effect the new Undertakings would have on the Company's Application. Having heard the submissions, the Board requested the Company to consider whether or not it wished to reframe its application in light of the new Undertakings. The Company provided a reframed application on December 18, 1998. This reframed application, as clarified by the Company in its Argument-in-Chief, is set out in detail in the next Chapter.

1.1.5 Having received the reframed application, the Board requested submissions from the Applicant and parties as to the appropriate timetable for continuing the Proceeding and, having received those submissions, the Board issued Procedural Order No. 7 on December 23, 1998. This Procedural Order established a revised issues list and ordered that the oral hearing commence on January 11, 1999. The oral hearing required seven hearing days, concluding on January 25, 1999. The argument phase was completed on March 8, 1999.

1.1.6 Copies of all the evidence, exhibits and argument filed in the Proceeding, together with a verbatim transcript of the hearing, are available for review at the Board's offices. While the Board has considered all of the evidence and submissions presented in this hearing, the Board has chosen to cite these only to the extent necessary to clarify specific issues on which it has made findings.

1.2 THE SETTLEMENT PROPOSAL

1.2.1 A Settlement Conference for E.B.O. 179-14 and E.B.O. 179-15 was held by the parties commencing November 16, 1998 and resulted in the settlement of only one of the issues, the one related to energy use and demand-side management programs. The settlement of this issue, as set out in the Settlement Proposal is described in Appendix A. The final result of the Settlement Proposal was presented to the Board on December 1, 1998. The settlement was accepted by the Board subject to updates, changes necessary as a result of the Board's Decision on unsettled matters, or as a result of unforeseen events.

1.3 PARTIES TO THE PROCEEDING

1.3.1 Thirty-five parties intervened. Below is a list of parties, including the Company, and their representatives who participated actively in the oral hearing by cross-examining or filing argument.

The Consumers' Gas Company Ltd. ("Enbridge Consumers Gas")	Jerry Farrell Fred Cass
Alliance Gas Management Inc. ("Alliance Gas")	Brian Dingwall

Alliance of Manufacturers and Exporters, Canada ("AMEC")	Beth Symes C. Street
Association of Municipalities of Ontario ("AMO")/ECNG Inc. ("ECNG")	Peter Scully
Coalition for Efficient Energy Distribution ("CEED")	George Vegh Elizabeth DeMarco
Consumers Association of Canada ("CAC")	Robert Warren
Energy Probe Foundation ("Energy Probe")	Mark Mattson
Green Energy Coalition ("GEC")	David Poch
The Heating, Ventilation and Air Conditioning Contractors Coalition Inc. ("HVAC")	Ian Mondrow
Industrial Gas Users Association ("IGUA")	Peter Thompson Bryan Carroll
Ontario Association of Physical Plant Administrators ("OAPPA")	Michael Morrison

Ontario Association of School Board Officials/Metropolitan Toronto Separate School Board ("the Schools")	Thomas Brett
Ontario Coalition Against Poverty ("OCAP")	Michael Janigan Philippa Lawson
Pollution Probe Foundation ("Pollution Probe")	Murray Klippenstein
Union Energy Inc. ("Union Energy")	Donald Rogers
Canadian Association of Energy Service Companies ("CAESCO")	Thomas Brett
Coalition of Eastern Natural Gas Aggregators and Sellers ("CENGAS")	Richard Perdue

1.3.2 In addition, the Board received three letters requesting observer status from other organizations and individuals, and two letters of comment expressing concerns regarding the Company's request to increase rates.

1.3.3 The Enbridge Consumers Gas' employees who appeared as witnesses are shown below.

L.A.E. Beattie	Vice-President, Energy Supply and Storage

R.A. Bourke	Manager, Regulatory Accounting
D. Charleson	Manager, Accounting Systems
G. J. Hills	Vice-President, Regulatory and Legal
J.A. Holder	Vice President, Market Development
W. Lomax	Manager, Financial Studies
R. Rackus	General Manager, Central Region
W. B. Taylor	Director, Financial and Economic Studies

1.3.4 In addition, the Company called the following witnesses:

K. McShane	Vice-President and senior consultant of Foster Associates Inc.

1.3.5 HVAC called the following witnesses:

R. Grochmal	Owner, Atlas Air Conditioning Company and Chair - HVAC Coalition
M. Luymes	Manager, Heating, Refrigeration and Air Conditioning Contractors of Canada ("HRAC"), a division of the Heating Refrigeration and Air Conditioning Institute of Canada ("HRAI")

P. Messenger	President and Owner of Messenger Mechanical Inc. under the trademark of A1 Air Conditioning and Heating

1.3.6 CAC, IGUA, OCAP and HVAC called the following witness:

Dr. J. Bauer	Associate Professor in the Department of Telecommunication, Michigan State University and a Research Associate in the Institute of Public Utilities.

2. THE COMPANY'S PROPOSAL AND PARTIES' VIEWS

2.1 THE ORIGINAL APPLICATION

2.1.1 In its original Application dated January 8, 1998, the Applicant proposed to separate and remove (or unbundle) the following from the existing operations of the regulated utility:

- its Merchandise Sales Program (or Merchandise Business Unit);
- its Heating Parts Replacement Plan or HIP; and
- approximately one half of the service operations currently provided to customers by the regulated utility under its Customer Maintenance Programs and Customer Appliance Repair and Diagnostic Service.

2.1.2 These ancillary services, together with the non-utility Merchandise Finance Program ("MFP") were proposed to be transferred to Consumersfirst Ltd. ("Consumersfirst"), a non-subsidiary affiliate of the Company, on October 1, 1999. The Company's proposal would result in Consumersfirst operating the transferred businesses outside of regulation. The Company proposed that its Natural Gas Vehicle Program ("NGV") and its rental program remain within the regulated utility, although it proposed to wind-down its rental program gradually.

2.1.3 As part of its Application, the Company requested the establishment of an Unbundling Business Activities Deferral Account to record costs incurred in the 1998 and 1999 fiscal years in relation to the transfers proposed. In addition, the Company requested approval of the Board for the ratemaking implications of its proposals relating to the rental program, including approval for the recovery from ratepayers of unrecorded deferred income taxes in relation to the program. This original Application was framed under the 1994 Undertakings.

2.2 THE REFRAMED APPLICATION

2.2.1 As noted in Chapter 1, the Board was advised that the 1998 Undertakings would supersede the 1994 Undertakings. While the 1994 Undertakings had required the Board's approval for affiliate transactions and diversification activities of the type proposed, the new Undertakings removed that requirement, replacing it with the following:

> *Consumers shall not, except through an affiliate or affiliates, carry on any business activity other than the transmission, distribution or storage of gas, without the prior approval of the Board.* (Article 2.1)

2.2.2 The reframed Application, under the new Undertakings, as clarified during the hearing, was described by the Applicant in its Argument-in-Chief as follows:

The Company requests that the Board grant the following under Article 2.1 of the 1998 Undertakings:

- *prior approval for the Company to carry on the business activity known as the Rental Program, in a wind-down mode, on and after October 1, 1999* *until the wind-down is completed, including the Rental Service Agreement with Consumersfirst Ltd. during the initial five years; and*

- *prior approval for the Company to carry on the business activity known as the ABC-T Program, in its current format, on and after October 1, 1999 and until the Board determines that the program should be discontinued.*

The Company also requests that the Board approve the following for rate-making purposes:

- *an Unbundling Business Activities Deferral Account in order to record and recover reasonably incurred costs, in the 1998, 1999, and 2000 fiscal years, in relation to the transfer, by the Company to Consumersfirst Ltd., of the assets that comprise, and of copies of the information software that is necessary to operate, the following businesses and activities: merchandise sales, heating parts replacement plan (also known as "HIP"), and certain service activities;*

- *the proposed regulatory treatment of the Rental Program in a wind-down mode, including the following:*
  - *the classification of the program as a core utility activity; and*
  - *the recovery from ratepayers, in due course on a taxes payable or "flow through" basis, of the Company's unrecorded deferred income tax liability in relation to the program as at September 30, 1999 (approximately $168.2 million), to the extent that such liability cannot be recovered from customers of the program; and*

- *the proposed Unbundled Budget for use in connection with the targeted Performance Based Regulation (PBR) plan that is before the Board in the E.B.R.O. 497-01 proceeding.*

2.2.3 The retention of other programs, including NGV, within the utility from March 31,1999 until the end of the fiscal year was requested by letter to the Board dated December 17, 1998. These requests have been approved by the Board in a letter dated March 24, 1999.

2.3 TRANSFERRED OUT PROGRAMS

2.3.1 The Company plans to transfer assets with a net book value of approximately $166.8 million to its affiliate, Consumersfirst, of which $140.7 million are receivables associated with the MFP, and the remaining $26.1 million consists of assets relating to the other programs. To ensure no tax payments are triggered by the transaction, the Company and Consumersfirst would elect under the *Income Tax Act* to transfer the assets, which have been assessed by KPMG as having a fair market value of $168.5 million, at book value. In return for the transfer of the assets, the Company would receive $166.8 million in cash and $1.7 million in preferred shares issued by Consumersfirst. These shares are expected to be redeemed for $1.7 million in cash immediately following the asset transfer.

2.3.2 The Company proposes to continue a management services agreement with Consumersfirst, the fully allocated cost of which is forecast to be $2.4 million annually following the transfer. The Company filed a set of Standards of Business Practice to apply to these activities. These Standards have been preempted subsequently by the Board's draft *Affiliate Relationships Code for Gas Utilities*.

2.3.3 Given that no Board approval is required for these transfers under the new Undertakings, it was not necessary to examine the valuations in detail. Any ratemaking implications will be subject to review in the next main rates case. As noted later in this Decision the Board accepts for removal from the cost of service the amounts identified, as adjusted to reflect the actual amounts at the date of transfer.

2.4 RETENTION OF THE ABC-T PROGRAM

2.4.1 The Company is requesting approval under the new Undertakings to continue the ABC-T Program as an ancillary program within the Utility on the basis of fully allocated costs. The evidence is that this optional billing and collection service provided by the Company to agents, marketers, and brokers is needed in the developing competitive retail natural gas commodity market, and that other alternatives are not yet available. It is the Company's expectation that "the fate of the program would be revisited in another regulatory proceeding before the program would disappear".

2.5 PROPOSED TREATMENT OF THE RENTAL PROGRAM

2.5.1 The Company's rental program currently serves approximately 1.2 million homes and businesses in the Company's franchise area. The Company proposed to wind-down this program, installing no new rental units after October 1, 1999, and replacing no existing rental units at the end of their useful lives. The Company proposed that the rental program would, during the wind-down, cease to be considered an ancillary program and become part of the core utility for regulatory purposes.

Rationale and Proposed Regulatory Treatment

2.5.2 The rental program was operated on a marginal cost basis until the Board's finding in E.B.R.O. 495 required fully allocated costing of the Company's ancillary programs. The Company's proposal to treat this program as part of the core utility would subsume the costs of the program into the utility's cost of service.

2.5.3 In its evidence in E.B.R.O. 497 the Company described the new competitive environment relating to rentals and the difficulties facing the rental program as competitors expand into the business of providing water heaters for sale, and promoting electric water heaters. Essentially, in that Proceeding, the Company requested an extension of the time during which it could operate its rental program on a marginal cost basis. Having not had its request granted, the Company wishes to withdraw from the rental business, and proposes the wind-down as a way to manage the transition.

2.5.4 It was the Company's view that, given the historic benefits it identified with the rental program, its anticipated lack of flexibility to manage revenues and mitigate the impact of premature equipment removals, the loss of economies of scale during the wind-down, and the aim of fostering competition, the rental investment should be treated as any other utility investment through the wind-down. The program would not, under the Company's proposal, be subject to fully allocated costs for regulatory purposes. Until the competitive infrastructure is in place to assure adequate service levels for rental customers, the Company proposes to enter into a five year service agreement with Consumersfirst; at the end of the term of this agreement, the Company states that Consumersfirst would have to compete for the utility business.

2.5.5 It is the Company's view that its wind-down strategy balances the interest of the shareholder in protection of its investment with the interests of customers in increased choice through an orderly transition to competitive markets. Existing customers may remain on the utility rental program until their equipment needs to be replaced, and will be made aware of alternative supply sources. The shareholder would, under the Company's proposal, recover the full costs of winding down the program.

2.6 DEFERRED TAXES

2.6.1 As a result of the Company's use of a "flow through" method of recording taxes relating not only to its regulated utility income but also to the income from the Rental Program, there would be unrecorded deferred taxes in the amount of $168.2 million attributable to rental assets as at the end of fiscal 1999. The Company proposed that ratepayers be responsible for the payment of these deferred taxes. In support of this proposal, the Company cites an analysis of the regulatory treatment of returns on ancillary programs over the past 10 years that indicated a resulting $151 million, on a current dollar basis, benefit to ratepayers over those years, $127.5 million of which is attributable to the rental program. Over the past 20 years, the Company estimated that the rental program had been responsible for approximately $172.5 million in current dollar benefits to ratepayers resulting from the regulatory treatment applied to earnings from it.

2.6.2 As a result of a recent Supreme Court Decision, Revenue Canada has changed the tax treatment of certain expenses associated with rental equipment. Because of this change, the Company was credited with $42 million of tax overpayment. This amount contributed to the total of $168.2 million deferred tax liability noted above. The Company proposed to credit the $42 million to the ratepayers conditional upon the Board accepting the Company's proposed wind-down and deferred tax treatment.

2.7 CONSUMERSFIRST SERVICE AGREEMENT

2.7.1 As noted above, the Company proposes to enter into a five year rental service agreement with Consumersfirst for the latter to provide service to existing rental products primarily consisting of rental water heaters. It is the Company's evidence that its affiliate is the only contractor capable of providing service comparable to that presently provided. At the end of the five year period, other contractors who can demonstrate the capability will be considered to provide this service. The Company contended that this agreement, as opposed to servicing through third parties, will prevent premature stranding of rental assets, because the two companies are commonly owned. The Company also argued that the contract will enable a smooth transition to a competitive market.

2.7.2 Based on a negotiated cost per unit serviced, the Company forecast that it will pay Consumersfirst $17.7 million in fiscal year 2000 to provide the rental equipment service. The Company stated that in its negotiations with Consumersfirst it undertook to ensure that the cost of the agreement would be equivalent to the cost of a Company-managed option using 100% contractor workforce. The Company's evidence indicated that the cost of the rental service agreement on a marginal cost basis is comparable to the cost of a Company-managed alternative.

2.8 STRANDED ASSETS

2.8.1 Assets no longer required for the operation of the core utility once the unbundling process is complete and therefore no longer "used and useful" were estimated at $400,000 after mitigation efforts by the Company. These assets comprise the net cost of telecommunication equipment and infrastructure costs associated with office space reductions. The Company proposed that the stranded costs from these assets be recoverable from ratepayers through depreciation.

2.11 PARTIES' VIEWS

2.11.1 The parties, with few exceptions, opposed the Company's proposals in whole or in part. Some noted that the onus was on the Applicant to satisfy the Board that the specific relief it was seeking should be granted, and that the Board could simply turn down the proposal entirely, if that onus was not met. The relief sought was characterized variously as "regulatory overreach", "excessive", and self-serving. Concerns were expressed that the Company was relitigating matters which the Board had clearly determined in previous proceedings, that there were no efficiency gains resulting from its restructuring, and that its proposed contract with its affiliate would distort markets and hinder competition. A number of parties pointed out that the shareholder had chosen to pursue ancillary programs for its own purposes, and must therefore accept the risks of a changing marketplace. Many argued that past benefits were overstated, and some submitted that past outcomes should not, in any case, necessarily determine the fate of the present Application.

2.11.2 There was general support, with one exception, of the Company's proposal to retain ABC-T Service.

2.11.3 With respect to the new Undertakings, parties suggested various tests that might be applied in determining whether business activities other than distribution, transmission and storage of gas should be permitted within the Company, and urged the Board to consider the context of the new legislation, its general purposes, the Board objectives set out in the legislation, the description of the purposes of the new Undertakings and their specific wording, and the general direction of change in the energy industry. Based on Dr. Bauer's testimony, parties urged the Board, at a minimum, to hold ratepayers harmless and apply the test of economic efficiency as a criterion in assessing the Company's requests.

2.11.4 Many parties noted that the Company had provided little in the way of evaluation of alternatives to its proposals. With respect to the deferred taxes, some parties questioned the jurisdiction of the Board to pass through into rates taxes relating to assets of ancillary programs. No party agreed that the "regulatory compact", as articulated by the Company's witness, Ms. McShane, guaranteed recovery of deferred taxes by the shareholder as suggested by the Company. One party suggested that the Board may have been "mistaken" in its past decisions relating to the treatment of taxes, but that it could redeem itself through the proper determination of the present application.

2.11.5 With respect to the proposed services contract with Consumersfirst, there were general concerns that the contract in essence amounted to a transfer of the rental program to the affiliate at no cost, and that in fact the Company would be paying its affiliate to acquire a profitable business as the Company wound down its participation. Evidence provided by witnesses on behalf of HVAC addressed concerns relating to fairness to others in the service industry, and protection of ratepayers from subsidizing an affiliate's entry into the market. Parties recommended that the Board consider these in evaluating the proposal.

2.11.6 A number of parties noted the complexity and difficulty of the issues in the Application. Although there was almost universal agreement that the Company's course should not be agreed to, parties did not generally provide alternative courses for the Board's consideration.

2.11.7 In reply, the Company urged the Board to take a narrower approach to its mandate in relation to competition than that argued for by some parties, noting that the new legislation speaks of the Board's role in facilitating competition in "the sale of natural gas" and in "the generation and sale of electricity". On the other hand, the Company dismissed as "astonishing" any suggestion that the Board does not have the jurisdiction to require ratepayers to pay the deferred tax liabilities. The Company urged the Board to adopt a "just and reasonable" standard in determining the extent to which ratepayers' and shareholders' interests should be protected, a standard it submited would be completely consistent with its proposals with respect to the treatment of the ancillary programs, and the deferred taxes.

3. BOARD FINDINGS

3.1 GENERAL

3.1.1 The Company wishes to retain the rental program within the core utility, wind it down, recover the resulting deferred tax liability from the ratepayers (to the extent that it cannot be recovered from the rental customers) and utilize an exclusive five year service agreement with its affiliate to provide service of the rental assets. The Company also requests approval to retain its ABC-T program within the utility. Additional approvals are sought relating to the costs of transferring other activities out of the utility and the resulting "unbundled budget" for use in connection with a proposed PBR Application that is under consideration by this Board in a related proceeding.

3.1.2 Thus summarized, the Company's proposals seem straightforward. As many intervenors have indicated, however, the matters under consideration in this Application are not only complex, but interwoven in complicated ways. In addition, the consequences are potentially momentous, in both policy and financial terms. It is necessary to carefully balance the interests of ratepayers, shareholders, and users of the programs in question, to consider the changing legislative, regulatory and market contexts, and to take into account previous Board findings and directives.

3.1.3 During the hearing the Board requested clarification from the Company of its expectations should the Board deny part or all of the relief requested. In its Argument-in-Chief, the Company responded, asking for "detailed guidance as to the Board's expectations...[to] enable the Company [if necessary] to design an alternative that would meet the Board's expectations and...facilitate the regulatory process." In setting out its findings in the following pages, the Board has been mindful of the effort that has gone into this Application by all involved, and of the need for regulatory efficiency to utilize that effort to move forward. While some intervenors have urged the Board to "just say no", this course appears to the Board to be wasteful. The Board has therefore attempted to craft a solution to address its concerns with the Application as proposed, and to provide the Company with sufficient information and guidance to allow it to make effective decisions about the way in which it will proceed. The Board has also, of course, addressed the separate requests for approval for transactions other than those relating to the rental program and the resulting deferred tax liability.

3.2 THE RENTAL PROGRAM

Retention Within the "Core Utility"

3.2.1 As noted earlier, the 1998 Undertakings changed the nature of the approvals required by this Board in relation to the Company's activities. The relevant paragraph of the Undertakings reads as follows:

> *Consumers shall not, except through an affiliate or affiliates, carry on any business activity other than the transmission, distribution or storage of gas, without the prior approval of the Board.*

3.2.2 The Board has no difficulty in accepting that the rental program is a "business activity" within the meaning of this paragraph, and the Company does not contend, nor does the Board accept, that the program is part of "the transmission, distribution or storage of gas". Had this been the Company's interpretation, it would not have seen the necessity for approval to retain the rental program.

3.2.3 The Board has reviewed the various positions of the Company and intervenors as to the Board's jurisdiction and role under the *Energy Competition Act*, the direction of policy change envisioned by the new legislation, and the extent to which the gas and electricity sectors must be treated identically or symmetrically. The provisions of the legislation relating to the two sectors are not the same, and while the Board accepts the need for a consistent regulatory approach, it is required under the new Undertakings to make determinations which have no equivalent in relation to the electricity utilities. These decisions must be informed by regulatory history and the Board's sense of the regulatory future. In this particular case, the Board finds that under certain circumstances the carrying on of the business activity of equipment rentals by the Company would be appropriate.

3.2.4 The Board is not prepared, however, to approve a proposal to run the rental program as part of the "core utility". The essence of such a proposal is that no separate costing of the program, and hence no assessment of its profitability is possible. Not only would the costs of the program not be assessed on a fully allocated basis, as the Board has previously directed, but there would be no way of assessing them at all. The extent of any cross subsidization by the ratepayers would be unknown, and there would be little incentive for the Company to operate the program as efficiently as possible. The Board notes as well that any stranded assets which might develop in the program would become a ratepayer responsibility.

3.2.5 The Board's finding with respect to retention of the rental program in the core utility is supported by its view of current regulatory policy, which encourages the development of a "pure utility", stripped of non-monopoly services. The Board recognizes that the issue of the rental programs within the electrical utilities is still under consideration. In the event that such programs are to remain in electrical utilities, the Board will need to apply consistent principles to their regulation. While it may not be necessary to follow the same timetable in the gas industry as may be envisioned for the electric utilities, the general principles with respect to costing of such programs should be the same. Retaining the Company's rental program in the core utility does not allow appropriate costing principles to prevail.

3.2.6 The Board would accept the program, for the time being, on a non-utility basis within the Company, with elimination of the program's costs on a fully allocated basis.

The Proposal to Wind Down the Program

3.2.7 The Company has stated that it does not wish to continue the rental program as a going concern, partly because it is unprofitable to do so under fully allocated costs. While the Company provided, in a transcript undertaking response, a "high-level summary" of its analysis of options leading it to conclude that its proposal was optimum, the Board was not provided with detailed information on options and their consequences. It is clear that "a key component" of the wind-down proposal is the proposed five year service agreement with Consumersfirst. It is also clear that in the Company's view the deferred tax implications of the wind-down proposal were preferable to those that would result from other options.

3.2.8 Whatever the Company's motivation in proposing the wind-down of the rental program, the Board is not convinced that it is either necessary, or the best solution in the circumstances. There is no convincing evidence on the record that competition is rapidly eroding the program's remarkably high market penetration. While according to the Company the program was not forecast to return the allowed rate of return for fiscal 1999, this was partly due to the Company's reclassification of certain diagnostic charges which resulted in additional direct costs of $3.1 million for the program, and additional allocated costs of $6.8 million. Reversal of the changes in accounting for diagnostic charges would have resulted in a forecast combined rate of return of 8.7% for the Company's four ancillary programs, most of which is attributable to the rental program. Even when the program does not yield the returns realized by the utility as a whole, it is not losing money, on any cost allocation basis.

3.2.9 The most important consequence of the fate of the rental program is the timing by which the deferred taxes associated with it must be either recorded or paid. The Board discusses this consequence below. While it is not appropriate for the Board to tell the Company what it should do with the rental program, the Board's proposed treatment of the deferred taxes will determine the parameters within which the Company must decide the fate of the program. If the Company does not wish to continue the program as a non-utility program, it does not need Board approval to transfer it to an affiliate or to sell it to a third party.

3.3 DEFERRED TAX LIABILITY

3.3.1 As noted earlier, approximately $168 million in deferred taxes are associated with the rental program, including a tax credit of some $42 million arising from the recent reversal of Revenue Canada's treatment of expenses associated with the installation of rental assets. In the Board's view, whoever is responsible for the payment of the deferred taxes should be entitled to this credit.

All of the tax credit to the

3.3.2 The Company has contended that the deferred tax liability is a ratepayer responsibility, arguing that ratepayers have benefitted from the deferral of the taxes through lower rates, and that there has been a cumulative shortfall in earnings flowing to the shareholder over the years as a result of the lower actual returns from the program. Intervenors have presented various reasons why the liability should not fall on ratepayers.

3.3.3 The Company relies heavily on earlier Board decisions and the "regulatory compact" for its contention that the deferred taxes should be recovered in rates. According to the Company, the Board's decisions and the consequential regulatory precedents imply, without question, a commitment ("the Commitment") that these taxes would be recovered in rates when they are due and payable in the future. The trade-off for this Commitment is that gas rates have been minimized for the many years leading up to the time when the future tax liability arrives.

3.3.4 A review of the history of the Board's considerations of the Company's tax methodology will be helpful in assessing the Company's argument in this respect.

<u>History</u>

3.3.5 The flow through or "taxes payable" method of recording taxes is an exception to the standards of the Canadian Institute of Chartered Accountants ("CICA") as expressed in the following excerpt from the current CICA Handbook:

...the taxes payable basis would be appropriate ... provided that there is a reasonable expectation that all taxes payable in future years will be:
(a) included in the approved rate or formula for reimbursement ***<u>and</u>***
(b) recoverable from the customer at that time.

3.3.6 The CICA Handbook, in setting out this exception to the usual rule that "the deferral method of income tax allocation should be used", notes that the exception would apply in very limited circumstances, and uses as an example of those circumstances "a company in the regulated utility field under the jurisdiction of an authority, which allows as an element of cost in setting rates only the amount of taxes currently payable".

3.3.7 The Company has used the flow through basis of recording its taxes for many years. The Board has reviewed the history of the treatment of taxes, as set out in the cases relied upon by the Company, and notes the following:

- In 1961, when the Company asked the Board to approve an amount in rates for deferred taxes relating to "plant expansion and replacement", the Board declined, citing uncertainty as to when or whether the Company would have to actually pay the taxes in question.
- The Company based a 1975 request for "interim rate relief" to collect deferred taxes in part on the improvement that would result in its "cash flow and financing ability", and cited risks which arose from postponing recovery of taxes.
- One of the reasons recovery of deferred taxes in rates was denied by the Board in the past was that adding to rates for the purpose requested was inconsistent with Government price restraint policies in place at the time to deal with high rates of inflation.
- More than ten years ago Board staff argued for the exclusion of the rental program from the utility operation; at the time, the deferred tax situation was not raised, although evidence filed in the present application suggests that a total unrecorded deferred tax liability of almost $250 million existed at that time, a significant portion of which would have related to rental assets.

- In the past five years, the regulatory treatment of the ancillary programs has been examined in each main rates case; the Board ordered the implementation of fully allocated costing for these programs in 1997.

3.3.8 In E.B.R.O. 497, the Company presented evidence that, on the fully allocated costing basis directed by the Board the previous year, the ancillary programs were forecast to produce a revenue deficiency of $21.3 million dollars. The Company requested that the Board not impute any revenues to the programs in the test year, essentially requesting relief from the application of full costing for the test year. Detailed probing during the hearing revealed that much of the forecast deficiency in these programs could be traced to the introduction by the Company of a separate charge for diagnostic services, and a charging to the ancillary programs of direct and allocable costs related to these services. When these costs were excluded, the forecast revenue deficiency for the programs was reduced to $3.7 million.

3.3.9 The Board expressed its concern in the E.B.R.O. 497 Decision that the costs relating to diagnostic services had not been identified previously in the fully allocated costs study which had been presented to the Board in E.B.R.O. 495. The result of this failure was that the true revenue deficiency of the programs in fiscal 1998 was not recognized, and the Company had, in effect, a transition period in which fully allocated costing did not apply to the programs. The Board declined to provide any additional transition period, and directed that full costing continue to be applied. In addition, the Board expressed its concern as to "what *other* costs properly belonging to either ancillary or non-utility activities are still missing in the Company's cost allocation". It now appears that the unrecorded deferred taxes relating to the ancillary programs were another such cost, and a large one.

The Commitment

3.3.10 The Board does not accept the Company's argument that its past decisions imply the Commitment claimed for the following reasons:

- Many of the Board's decisions addressed whether deferred taxes should be collected in rates of the year in question. No distinction was made between the utility in general and its ancillary programs, although it is noteworthy that aspects of the Company's business, such as exploration and development, were treated differently. These decisions were based on circumstances at the time in question, such as the existence of high inflation, the status of the Company's cash flow and financing capabilities, and the extent to which the Board was persuaded that the Company's future was at risk from competition with other forms of energy or a future shortage of natural gas.
- Some of the decisions dealt with the extent to which a return should be allowed on the deferred taxes, not on a change to the tax methodology itself.
- The Company relies in the present Application on the Board's conclusion in 1976. In that Decision, the Board's statement that "...it is not reasonable to expect that the Applicant would be unable to obtain regulatory approval for the collection of deferred taxes in rates when they become payable, or that competition with other forms of energy would prevent the collection in rates due to a loss of customers" was in response to a Company argument that a future shortage of gas or competition with other energy forms might affect the Company's ability to recover the taxes following the crossover point.
- Where the decision requested was for a change in principle from flow through tax accounting to normalized accounting, the Board relied on its earlier decisions, and did not address the principle.

- The "regulatory compact" does not operate in such a way as to prevent the Board from considering new circumstances and changing its approach in response to them.
- The Company argues that the rental program has always been treated as part of the utility. The Board has never set rental rates, and has always required separate reporting for the ancillary programs. Taxes paid on income from the programs were expected to be part of the expenses directly assigned to the programs. While rates were set on the basis of a forecast rate of return from the rental program which took into account the taxes payable, it is not entirely clear to the Board that the CICA guideline applied to the program at all. Certainly once full costing of the rental program was required, it is difficult to see how the CICA guideline applied. The point was never raised before the Board.
- Even if one accepts that earlier Board decisions did not differentiate between taxes relating to ancillary programs and taxes relating to the utility, it is remarkable that the Company did not alert the Board to the deferred tax problem when the question of the costing of the ancillary programs was under consideration. The Company was undoubtedly aware of the unrecorded deferred tax liability related to these programs. It appears to the Board that its existence was an essential piece of information that should have been available to the Board in its review of the regulatory treatment of these programs. Consideration of a different costing treatment for the rental program commenced as early as 1995 (E.B.R.O. 490). Indeed, in E.B.R.O. 497, the Board expressed its concern "as to what other costs properly belonging to either ancillary or non-utility activities are still missing in the Company's cost allocation". It is notable that the amount of the liability related to the rental program has increased by approximately $50 million dollars since 1995, a period in which there has been considerable discussion of the characterization of costs relating to this program.

3.3.11 Considering all of the above, it is the Board's view that the deferred taxes associated with the rental program should be the responsibility of the shareholder. In the circumstances, the Board does not need to decide whether it has the jurisdiction to pass these costs directly through to the ratepayer in rates. As noted above, the $42 million credit for tax overpayment should, therefore, be credited to the shareholder.

Ratepayer Savings

3.3.12 It is instructive to consider who would have paid the taxes related to the rental program had they not been deferred. The Company's evidence is that rental rates were set by the market, and were not therefore dependent on the program costs. If one accepts that evidence, it follows that the renters would not have paid any more or less had the taxes not been deferred.

3.3.13 The Board cannot accept the Company's premise that rental rates were in fact set by the market as the Company states. The rental business, while competing to some extent with similar programs run by the electricity utilities, was in some senses a "monopoly business", with an approximately 95% market share in the Company's franchise area. Unfortunately, there is no evidence to suggest what differential existed between rental prices as set by the Company and those that would have been determined by the market. To the extent that prices were set to cover costs of the program, renters would have been responsible for paying the taxes, and would have benefitted from their deferral. The Board can only assume that there was some benefit; it cannot be quantified.

3.3.14 In order to analyze who else would benefit from the deferral, or, in other words, who else would have paid the taxes had they not been deferred, it is useful to accept for the purposes of the analysis that rental prices were set by the market, and thereby exclude possible benefits to renters from the analysis for the moment.

3.3.15 For most of the life of the rental program, its costs have been determined on a marginal basis. If one assumes that the taxes on the income of the rental program were charged to the program *as a direct charge*, and that the tax shelter related to the rental assets was applied directly to those taxes, the treatment of the taxes would have been the same under either marginal or fully allocated costing, since direct charges are attributed to the program under either regime. The deferral of the taxes would have, in any given year, lowered the cost of the program. Who benefitted from that lower cost?

3.3.16 To answer this question, it is necessary to note that the setting of utility rates on a forecast basis has the following results:

- if the forecast rate of return for the rental program was higher than the overall allowed rate of return, utility rates would have been set to reflect the higher return from the program, and ratepayers would have benefitted;
- to the extent that the actual rate of return for the program was higher than that forecast, shareholders would have benefitted; and
- to the extent that the actual rate of return was lower than that forecast, the risk being symmetrical, the shareholder would have absorbed the shortfall.

3.3.17 The Company has provided forecast and actual returns over the last ten years. From these, the following can be established:

- On a forecast basis, between 1989 and 1998 there was a total sufficiency from the program of $50 million.
- There are also some benefits to ratepayers from the reduction of fixed costs through incremental gas sales attributable to the rental program and the improvement in system load factor. Although these benefits would also have arisen if the rental program were owned and operated by a third party, it seems unlikely that the high market penetration the program achieved would have occurred had the utility not operated the program. In addition, it should be noted that rental customers are also ratepayers; almost 95% of ratepayers are also renters. To the extent that renters, who are also ratepayers, have not paid higher rental rates to cover costs of the program, they have benefitted.

3.3.18 It is not, in the Board's view, fair to revisit earlier regulatory treatment which allowed the program to operate on a marginal cost basis and calculate for this period a 'subsidy' to the rental program from the general body of ratepayers. The regulatory regime was what it was. However, even if such consideration were justified, the evidence reveals such 'subsidy' is only a portion of the $50 million sufficiency noted above.

3.3.19 It therefore appears to the Board that utility ratepayers have benefitted from the rental program over the years, and that the shareholder has absorbed some costs. While finding that ratepayers should not be responsible for the deferred tax liability, *per se*, related to the rental program, the Board believes that there should be some recognition of the benefits they have received in the past. The Board therefore would accept the provision of a notional utility account in the amount of $50 million, after tax, to allow the shareholder to use the value of these past ratepayer benefits to pay a portion of the deferred taxes associated with the rental program as they become due. It is up to the Company to determine the future of the program, but whatever that choice, the notional account can be drawn down to pay deferred taxes up to $50 million.

3.3.20 There are a number of options which the Company may consider with respect to the rental program, each with its own consequences for the rate at which the deferred taxes will come due. The options include:

- The Company may choose to continue to operate the program as a non-utility program for the time being. As the taxes become due, they will be accounted for as costs for potential elimination as non-utility expenses, as they are not common costs. It is possible that the deferred tax liability would need to be recorded immediately, even though payment is not immediately required.
- The Company may choose to wind-down the program as a non-utility program. In this case, the necessity to pay the deferred taxes will be accelerated.
- The Company may choose to transfer the assets to an affiliate or sell the program to a third party. In these circumstances, any proceeds from the sale or transfer would be available to address the related tax consequences. To the extent that the Company proposes to utilize any or all of the notional account as well, the Board's approval of the ratemaking consequences would be required. The Company should be aware that, under this option, consideration of 'rate shock' may dictate the degree of amortization of the amount to be reflected in rates going forward.

3.3.21 In any of these cases, the Company may draw on the notional account to pay deferred taxes as they become due. If the Company decides to continue the program, it will have an incentive to run it as efficiently as possible, since it must account for it on a fully costed basis. In any year, the amount used from the account would be recognized in rates, subject to considerations of 'rate shock' as noted above.

E.B.O. 179-14
E.B.O. 179-15

OEB RULING ON MOTION BY ENBRIDGE CONSUMERS GAS

By Notice of Motion filed on June 11, 1999, Enbridge Consumers Gas, ("the Company", "the Applicant") requested that the Board review or rehear portions of its Decision with Reasons dated March 31, 1999 in E.B.O. 179-14/15. The original application was for all necessary approvals of transactions related to the transfer of certain information systems, businesses and activities to affiliates, and included an application to retain the Company's Rental Program within the core regulated utility. The portions of the Decision with Reasons that are the subject of the request for review or rehearing are those portions that address deferred taxes associated with the Company's Rental Program. The Board determined in the Decision that distribution ratepayers were not responsible for payment of those taxes, but that the Board would allow the Company to set up a notional utility account of up to $50 million, in recognition of the benefits these ratepayers received as a result of the existence of the Rental Program, that could be drawn down as stipulated in the Decision.

Prior to filing its motion, the Company had petitioned the Lieutenant Governor in Council under section 34 of the *Ontario Energy Board Act, 1998* to require the Board to review the Decision. By letter dated July 13, 1999, the Board requested clarification from the Company of its view of the relationship between this motion and the petition to Cabinet. By letter dated July 21, 1999, the Company stated that in its view, a determination by the Board that it would hold a hearing to review portions of the Decision would render the petition moot, and it therefore requested the Board to proceed to deal with the motion.

The Board issued its Notice of Hearing of Motion on this matter on July 28, 1999, indicating that it would consider the "threshold question" beginning on August 10, 1999, and that, if appropriate, it would then proceed immediately to hear the merits of the motion.

The Company had requested that the motion be heard by "the entire panel of full time Board members, or, alternatively, by a panel which included the Chair and Vice-Chair of the Board". At the outset of the Hearing on August 10, 1999, the Board noted that the three member Panel appointed to consider the motion was not constituted in the manner requested by the Company. It consisted of the two Board members who had heard the matter originally and a third who had not been part of the E.B.O. 179-14/15 panel. The Company and intervenors were asked whether there were objections to the composition of the Panel. None were raised.

Before hearing submissions as to whether it should review or rehear any portion of its Decision, the Board considered an application by Enbridge Inc., the parent of the Company, for intervenor status in this matter. Having heard the submissions, the Board denied the request in relation to the hearing of the threshold issue, stating that it would reconsider whether it would be assisted by the intervention of Enbridge Inc. if it were to decide to rehear the matter.

The hearing of the threshold issue was completed on August 11, 1999.

Subsection 21.2 (1) of the *Statutory Powers Procedure Act* provides:

> *A tribunal may, if it considers it advisable, review all or part of its own decision or order, in accordance with its rules made under section 25.1, and may confirm, vary, suspend or cancel the decision or order.*

As pointed out by the Applicant, the power is a broad one, subject only to the requirement that the tribunal have rules to govern the process, which the Board has. The Board's Rule 63.01(a) requires a notice of motion for a review or rehearing to

> *... set out the grounds upon which the motion is made, sufficient to justify a rehearing or review or raise a question as to the correctness of the order or decision, which grounds may include,*
>
> *(i) error of law or jurisdiction, including a breach of natural justice;*
>
> *(ii) error in fact;*
>
> *(iii) a change in circumstances;*
>
> *(iv) new facts that have arisen;*
>
> *(v) facts that were not previously placed in evidence in the proceeding and could not have been discovered by reasonable diligence at the time;*

> (vi) *an important matter of principle that has been raised by the order or decision; ....*

The Applicant noted that the list of grounds set out in the rules did not appear to be exhaustive.

The Board's attention was drawn to a number of cases in which the courts have considered powers of administrative tribunals to reconsider matters that have been the subject of their decisions. Having reviewed the cases and heard submissions by the parties, the Board is of the view that the Board should not rehear matters simply because one of the parties to the original application was dissatisfied with the result or otherwise no matter might ever be finally determined.

The Applicant relied principally on subsections (a)(ii) and (a)(vi) of Rule 63.01, arguing that "brand new evidence" is not required to support a request for rehearing.

As to subsection (a)(ii), the Applicant alleged that the Board erred in fact in describing the extent to which "the deferred tax problem" was raised in earlier Board proceedings. The Company pointed to references to the subject of deferred taxes in oral testimony in earlier cases and in answers to interrogatories as evidence that the "the Company did alert the Board to the deferred tax problem".

The "deferred tax problem" at its most basic is the question of whether the deferred taxes relating to the Rental Program, when they become due, should be the responsibility of the distribution ratepayer. However, for the Company merely to mention the term "deferred taxes", or even to provide tables in an answer to an interrogatory does not, in the Board's view, cause the Board and all parties to consider the question of whether these taxes are the responsibility of the distribution ratepayer. The Board's comments in its Decision concerning the extent to which the subject of deferred taxes had been raised in earlier hearings were not in error, given that the Board was referring to a complete discussion of the issue of responsibility for the ultimate payment of the taxes.

In order to qualify under the CICA guideline allowing taxes to be collected on a flow-through basis, and thus give rise to a deferred tax liability, the Company must have

> a reasonable expectation that all taxes payable in future years will be:
>
> (a) included in the approved rate or formula for reimbursement <u>and</u>
> (b) recoverable from the customer at that time.

If it had such an expectation, the Company may not have wished to raise the question of whether the deferred taxes relating to rental assets would be the responsibility of the distribution ratepayer rather than the Rental Program participant when these taxes became payable for the Board's consideration, as raising the question would belie its "reasonable expectation" and imply that the guideline did not apply. That the Company may have felt it could do no more without bringing into question the applicability of the guideline does not result in Board agreement that the guideline was applicable. Whatever the reasons, no complete discussion of the responsibility for payment of Rental Program taxes, currently deferred, took place. Consequently, the Board was not in error in commenting on the absence of such a discussion.

The Applicant also alleged that the Board erred in its reference in E.B.R.O. 497 to the unrecorded deferred taxes as a "cost" that was not considered when the Board was reviewing the cost allocation methodology of ancillary programs in E.B.R.O. 495, arguing that the taxes "were beyond the scope of the cost allocation [study]". The Board was not, in its comment, suggesting that the taxes ought to have been included in the technical cost allocation exercise, being, as they are, direct costs of the ancillary programs. Nor did the Board suggest that its decision in E.B.R.O. 495 on the appropriateness of fully allocated costing for the ancillary programs had an "impact on deferred taxes" or was a "watershed in relation to the deferred tax issue". The Board's reference related again to the Board's surprise that the issue of responsibility for these substantial costs was not more explicitly presented at a hearing in which costs related to ancillary programs were central.

In any case, to be grounds for a review or rehearing, the errors of fact alleged must be errors capable of affecting the outcome of a decision. The Board's comments on the extent of disclosure of the issue in earlier cases was not determinative of the issue of whether or not the Company could obtain the approval it requested to retain the Rental Program in the core utility. The Board was simply commenting on the fact that the issue had not been fully discussed previously in proceedings that dealt extensively with the costs associated with the ancillary programs.

The Company also relied on subsection (a)(vi) of Rule 63.01. It argued that the applicability of the CICA guideline to the Rental Program was a matter of principle raised by the Decision. In the Board's view, the question of the responsibility for the payment of the deferred taxes relating to the Rental Program, and therefore the applicability of the guideline to the program, was fully aired and argued in the original hearing. It is therefore not a principle "raised" by the Board's Decision, but a principle the applicability of which was at issue before the Board, and upon which the Board made a decision.

The Company also argued that the existence of a "regulatory compact" and the circumstances under which it can be changed is a matter of principle raised by the Board's Decision. The Company itself supported its original application by extensive references to earlier Board decisions. Other parties responded. The Board's conclusion that the earlier cases did not support the Company's claim that there had been a commitment on the Board's part to allow the deferred taxes relating to the Rental Program to become the responsibility of the distribution ratepayer is not a principle raised by the Board's Decision, but the outcome of the Board's consideration of the arguments of the Company and others.

The Applicant argued that a further important matter of principle is raised by the failure of the Board to give appropriate weight to changes in government and legislative policy in its Decision. The Board, in its preamble to its findings in the Decision, made explicit reference to its consideration of "the changing legislative, regulatory and market contexts". This consideration led the Board to conclude that it would be inappropriate to "just say no"(which was argued by intervenors) to the Company's proposal, and that regulatory efficiency demanded a more innovative solution. The Company's dissatisfaction with the outcome does not negate the Board's recognition of these policy changes.

With respect to the capping of the notional utility account at $50 million, in recognition of the benefits ratepayers had received as a result of the existence of the Rental Program, the Applicant argued that there are matters of principle raised by the Decision in its use of that figure, rather than either one based upon a 20 year calculation or one that is future valued. The Board does not believe that the amount at which the account is capped is, in fact, a principle but rather a conclusion reached by the Board that the Company does not agree with. The principle, in this instance, is whether or not the full amount of deferred taxes related to the Rental Program should become the responsibility of the distribution ratepayer or the shareholder – an issue, as noted previously, fully discussed in the original hearing.

The Company further submitted that the impact of a decision may be grounds for rehearing the matter. The Company had requested approval for its plans relating to the Rental Program. It had every opportunity in the original hearing to present evidence about the impact of the Board's refusing its request. In fact, the Board requested clarification from the Company during the hearing about its expectations should the request be denied. As noted in the Decision, the Company responded to the Board's request in its Argument-in-Chief, asking for "detailed guidance as to the Board's expectations...[to] enable the Company [if necessary] to design an alternative that would meet the

Board's expectations and...facilitate the regulatory process". In the interests of regulatory efficiency the Board did not accede to intervenors' requests that it refuse the Company outright. Instead, it provided what guidance it could. That the guidance was not what the Company would have wished for, and has an impact that the Company did not foresee, is not, in the Board's view, appropriate grounds for review or rehearing. In any case, the Board left it up to the Company to determine the future of the program, a determination that would affect the impact of the Board's decision.

Based on all of the above, the Board finds there are insufficient grounds for the Board to rehear or review the matter of deferred taxes related to the Rental Program as requested by the Company.

Intervenors requested to recover their reasonably incurred costs relating to this motion. The Board so finds and orders the Company to pay 100% of those costs, subject to the Board's process.

The Board's costs shall be paid by Enbridge Consumers Gas upon receipt of the Board's invoice.

DATED At Toronto August 17, 1999.

On behalf of the Board Panel - H.G. Morrison, P. Vlahos, F.A. Drozd

Paul Vlahos

Paul Vlahos

TAB 3

Ontario Energy Board
Commission de l'Énergie de l'Ontario

RP-2002-0135 1

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, C.15, Schedule B; 2

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc., formerly The Consumers' Gas Company Ltd., for an order or orders approving or fixing rates for the sale, distribution, transmission and storage of gas for its 2002 fiscal year; 3

AND IN THE MATTER OF a proposal by Enbridge Gas Distribution Inc., formerly The Consumers' Gas Company Ltd., to establish a Deferred Income Tax Deferral Account and other related matters. 4

BEFORE: 5

Howard Wetston, Q.C. 6
Chair and Presiding Member

Paul Vlahos 7
Member

DECISION AND ORDER 8

December 3, 2003 9

In the EBO 179-14/15 proceeding, Enbridge Gas Distribution Inc. (EGDI) sought Board approval 10
to include its water heater rental program as part of the core utility. EGDI intended to wind down the rental program which would trigger a requirement to pay taxes that had been previously deferred. EGDI proposed to recover those taxes from ratepayers, to the extent that they could not be recovered from rental customers.

In its decision, dated March 31, 1999, the Board rejected EGDI's request, on the basis that the rental 11
program was an ancillary program that was not regulated by the Board. The Board's treatment of the rental program had focused on ensuring that it was not subsidized by ratepayers. The Board determined that any deferred taxes associated with the rental program that became payable would be the responsibility of the Company and not ratepayers. However, by comparing the rate of return on the rental program with the Board approved rate of return for the utility, the Board recognized that ratepayers did benefit to some extent from the rental program. On a forecast basis, the Board found that between 1989 and 1998 there was a total sufficiency from the program of $50 million, after tax.

On June 11, 1999, EGDI filed a motion asking the Board to vary its decision. The motion was denied 12
on August 17, 1999.

Then, on October 15, 1999, EGDI brought an application for judicial review to the Divisional Court, 13
Ontario Superior Court of Justice.

On October 1, 1999, EGDI transferred the rental business to is affiliate, Enbridge Services inc. The 14
rental business was eventually sold to Centrica North America on May 7, 2002.

While the application for judicial review was still pending, EGDI sought to draw down from the 15
notional account as part of the RP-1999-0001 proceeding, dealing with fiscal 2000 rates. In its decision, dated December 16, 1999, the Board denied the Company's request to recover the requested amount for deferred taxes in the test year on the basis that it was not clear if and how the rental program would be wound down thereby triggering incremental taxes payable within the affiliate.

In RP-2000-0040, dealing with fiscal 2001 rates, EGDI requested a deferral account to recover $50 16
million, after taxes, over ten years. The Board removed the matter from the Issues List because the Company's application for judicial review was still pending.

EGDI's application for judicial review to the Divisional Court was denied on December 19, 2001. 17

Subsequently, in RP-2001-0032 dealing with fiscal 2002 rates, EGDI requested a deferral account 18
to recover $50 million, after taxes, over nine years. As part of an ADR agreement, the parties agreed that they would ask the Board to initiate a separate proceeding to deal with this issue. The Board accepted the ADR agreement.

The present proceeding was established to deal with the issue, upon the completion of the RP-2001- 19
0032 proceeding. The parties to this proceeding are EGDI, IGUA, CAC and VECC.

EGDI seeks to recover $50 million in rates based on its interpretation of the Board's original decision 20
in EBO 179-14/15. EGDI's claim is opposed by IGUA, CAC and VECC ("the Intervenors").

In order to deal with EGDI's claim, the Board issued a procedural order. A joint submission was 21
received from the Intervenors. EGDI filed a responding submission and the Intervenors filed a reply submission.

The position of IGUA, CAC and VECC 22

The Intervenors argued that EGDI's original request was for contingent relief, in that EGDI wanted 23
to run the rental program as part of the core utility, and to the extent that it could not recover deferred taxes from the rental customers as the became payable, it wanted to collect those amounts in rates.

The Intervenors submitted that it is clear that the Board had rejected EGDI's request and granted 24
different relief which was also contingent. They argued that the Board's decision was clear that the $50 million notional utility account was to be drawn on only as taxes became payable. This is reinforced in the RP-1999-0001 Board decision, in which the Board rejected EGDI's request to draw on the notional utility account in the absence of being able to ascertain whether any taxes were actually payable.

The Intervenors further argued that the Board did not find that EGDI was unconditionally entitled 25
to receive $50 million from the ratepayers. EGDI's request to recover the full $50 million from ratepayers is inconsistent with its original request, the Board's decision, and also the Board's approach in RP-1999-0001.

The Intervenors contended that after the rental program assets were transferred from the utility to 26
an affiliate, they were again transferred to another affiliate and operated on a wind down basis, triggering the requirement to pay previously deferred taxes. The Intervenors submitted that this is an artificial wind down that was intended to trigger the requirement to pay taxes in order to draw upon the notional utility account, and under those circumstances, the Board should not allow recovery of those taxes from that account. If the assets had been kept as part of the ongoing rental program operated by the first affiliate, the obligation to pay taxes would not have been triggered because of the continuing investment in the rental program by that affiliate.

The Intervenors argued that the appropriate interpretation to give to EBO 179-14/15 is that it was 27
not an unconditional grant of $50 million after taxes, but rather an obligation on ratepayers to pay up to $50 million tied to and conditional upon the future payment of income taxes. This was to prevent a possible erosion of returns in future years as result of the inability of the rental equipment business to completely cover its deferred tax liability on a stand-alone basis. The Intervenors concluded that EGDI is only entitled to draw on the notional utility account for any taxes that became

payable between October 7, 1999 (the date in which the assets were transferred out of EGDI to an affiliate) and May 7, 2002 (the date of the sale of the rental assets to a third party).

The Intervenors also took the position that EGDI's ability to draw on the notional utility should be limited to the amount of deferred taxes that would have been payable, had the assets been kept within the first affiliate and operated on an ongoing basis, rather than transferred to a second affiliate and operated on a wind down basis. 28

The position of EGDI 29

EGDI argued that the Board's method of giving recognition to the benefits received by ratepayers in the rental program was to allow the Company to establish a notional utility account in the amount of $50 million, after tax. This notional utility account is not a deferred taxes account. Instead it is an account that recognizes the Board's finding of a $50 million sufficiency from the rental program. 30

EGDI contended that in setting up the notional utility account, the Board was addressing the question of "how" the $50 million of ratepayers benefits could be recovered and not "whether" the benefits could be recovered in rates. 31

EGDI pointed out that the decision of the Divisional Court in EGDI's judicial review application held that the Board was required to balance the impact of deferred taxes between ratepayers and the shareholder and that the Board's balancing was just and reasonable. EGDI argued that IGUA, CAC and VECC want to upset this balancing by depriving the Company of any opportunity to recover the $50 million of ratepayer benefits recorded in the notional utility account. 32

EGDI indicated that, in the aftermath of the Board's EBO 179-14/15 decision, it has treated the $50 million notional utility account as a regulatory asset. To the extent that the Company cannot recover the full $50 million, there will be an equivalent reduction in the net after-tax income of the Company. 33

EGDI argued that the fact that the rental assets were transferred into an affiliate and operated in a wind down mode is completely consistent with the Company's original proposal, which was to wind down the rental program as part of the core utility. 34

EGDI held that the EBO 179-14/15 decision does not contemplate that the sale of the rental program to a third party on May 7, 2002 would affect the recovery of the amount recorded in the notional utility account. 35

EGDI submitted that it would be inappropriate to deny recovery of the $50 million of ratepayer benefits recorded in the notional utility account because of the sale to a third party. The fact of the sale does not affect the $50 million of benefits that were delivered to the ratepayers from the rental program and which the Board had determined should be recognized. 36

EGDI noted that, in the EBO 179-14/15 decision, the Board undertook the balancing of interests and found that the gas distribution ratepayers should pay back $50 million of the benefits that they had received from the rental program. The mechanism created by the Board for the recovery of the $50 million was a notional utility account against which the Company could draw as deferred taxes became payable. Since this mechanism is no longer available because of the sale of the assets, the Company requests direction from the Board as to what mechanism for recovery should now be used. 37

Reply by IGUA, CAC and VECC 38

In their reply, the Intervenors reiterated their argument that the Board clearly linked the notional utility account to the payment of deferred taxes as they became due. When the Board, in its reasons for decision, discussed the option of selling the rental business to a third party, the Board specifically noted that "any proceeds from such a sale would be available to address the related tax consequences". This reflects the Board's intention that the notional utility account was to be drawn upon only to the extent that it was necessary to do so to pay taxes. 39

The Intervenors argued that the fact that EGDI recorded the $50 million notional utility account as a regulatory asset is not relevant since it did so without consultation and the appropriateness of this treatment was never determined by the Board. EGDI's decision to record the $50 million as a regulatory asset was done after the fact and is not relevant to the issue of the interpretation to be given to the EBO 179-14/15 decision. 40

The Intervenors argued that, in striking a balance, the Board awarded EGDI conditional relief. EGDI now seeks to convert that conditional relief into an absolute obligation for ratepayers to pay $50 million after taxes. There is nothing in the Divisional Court decision that suggests that the Court's view was that ratepayers were under an absolute and unconditional obligation to pay $50 million after taxes as a result of the Board's decision. 41

The Intervenors argued that the triggering of the requirement to pay taxes that resulted from the transfer of the rental program assets to a second affiliate, which then operated them in a wind down mode, is a product of a strategy that gives rise to a windfall gain if those taxes are to be recovered from the notional utility account. 42

The Intervenors submitted that the Board found that ratepayers should share the potential exposure to pay taxes previously deferred up to a maximum of $50 million. As a result of the sale of the rental assets to a third party, there is no further exposure to taxes and so there should be no further payment from the notional deferral account beyond what is required to recover taxes that became payable prior to the sale. 43

Board's Findings 44

This is a somewhat unusual proceeding. We are not sitting on a review or appeal of the original decision. Rather, we have been asked to interpret a Board decision so as to give it effect. 45

The pivotal issue the Board must decide is whether the creation of the notional deferral account is 46
linked to the payment of income taxes in future years, or whether it represents an unconditional obligation by EGDI's ratepayers to pay an after tax amount of $50 million as compensation for past benefits received from the rental program.

At paragraph 3.2.2 of the EBO 179-14/15 decision, the Board quoted EGDI's application with 47
respect to the regulatory treatment of the rental program. It read:

> The recovery from ratepayers in due course on a taxes payable or "flow through" 48
> basis of the Company's unrecorded deferred tax income tax liability in relation to the program as at September 30, 1999 ...

At paragraph 3.3.19 of its EBO 179-14/15 decision, the Board stated: 49

It therefore appears to the Board that utility ratepayers have benefited from the rental program over 50
the years, and that the shareholder has absorbed some costs. While finding that ratepayers should not be responsible for the deferred tax liability, per se, related to the rental program, the Board believes that there should be some recognition of the benefits they have received in the past. The Board therefore would accept the provision of a notional utility account in the amount of $50 million, after tax, to allow the shareholder to use the value of these past ratepayer benefits <u>to pay a portion of the deferred taxes associated with the rental program as they become due</u>. It is up to the Company to determine the future of the program, but whatever that choice, <u>the notional account can be drawn down to pay deferred taxes up to $50 million</u>. [Emphasis added]

In paragraph 3.3.20, the Board identified three options that the company might consider: (i) continue 51
to operate the rental program as a non-utility program for the time being; (ii) wind down the program as a non-utility program; or (iii) transfer the assets to an affiliate or sell the program to a third party.

In relation to option (iii), the Board noted: 52

> In these circumstances, any proceeds from the sale or transfer would be available 53
> to address the related tax consequences. To the extent that the Company proposes to utilize any or all of the notional account as well, the Board's approval of the rate-making consequences would be required. The Company should be aware that, under this option, consideration of 'rate shock' may dictate the degree of amortization of the amount to be reflected in rates going forward.

In paragraph 3.3.21, the Board stated: 54

> In any of these cases [three options], the Company may draw on the notional account 55
> <u>to pay deferred taxes as they become due</u> . [Emphasis added]

EGDI first sought to draw against the notional account in RP-1999-0001. In paragraph 3.1.6 of its RP-1999-0001 decision, the Board stated: 56

> Payment of the deferred taxes associated with the rental program arises according to the Company from a wind down mode. However, the testimony by the Company's witness is neither definitive that the rental program will be "wound down" nor clear as to how it will be "wound down" thereby triggering incremental taxes payable within the affiliate. The Board is not prepared to consider the other arguments by the parties unless there is a better understanding on these issues, which must come from a more complete and clear record. The Board therefore denies the Company's request to recover the requested amount for deferred taxes in the test year. 57

The above excerpts represent the core of the Board's decisions in this matter. We are of the opinion that these reasons do not support EGDI's view that the Board's decision in EBO 179-14/15 represents an unconditional obligation for the ratepayers to pay $50 million, after tax. The Board clearly intended that EGDI would be able to recover from the notional account only as deferred taxes became payable, and only up to $50 million, after tax. 58

The Board therefore confirms that draws against the notional account are limited to $50 million, after tax, and are conditional upon deferred taxes associated with the rental program becoming payable. 59

The Intervenors argued that EGDI's ability to draw on the notional utility should be limited to the amount which would have been payable in taxes, had the assets been kept within the first affiliate and operated on an ongoing basis, rather than transferred to a second affiliate and operated on a wind down basis. In our view, the language in the Board's EBO 179-14/15 decision does not support this interpretation. This interpretation would preclude, in effect, EGDI and its affiliates from engaging in normal tax planning in order to optimize exposure to deferred tax liability. In fact, one of the options identified by the Board in the EBO 179-14/15 decision specifically contemplates transferring the rental program assets to an affiliate or selling to a third party. 60

The rental program assets have been sold to a third party. As such, neither EGDI nor its affiliates bear any further tax liability post the date of the sale in relation to those assets. 61

The Board finds and orders that EGDI is entitled to recover from the notional utility account an amount, after taxes, equal to the deferred taxes that became payable between October 7, 1999 (the date in which the assets were transferred out of EGDI to an affiliate) and May 7, 2002 (the date of the sale of the rental assets to a third party). EGDI may seek to recover such amount, appropriately verified, in its next rates application. The Board expects EGDI to ensure that its request for recovery includes consideration of any potential for rate shock. 62

The Board will issue its decision on costs at a later time. 63

DATED at Toronto, December 3, 2003

Howard Wetston, Q.C.
Chair and Presiding Member

Paul Vlahos
Member

TAB 4

Ontario Energy Board | Commission de l'Énergie de l'Ontario

Ontario

RP-2003-0203

IN THE MATTER OF AN APPLICATION BY

ENBRIDGE GAS DISTRIBUTION INC.

FOR RATES FOR FISCAL 2005

DECISION WITH REASONS

November 1, 2004

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A - Issues List

B - Settlement Proposal

C - Decision on Motion - May 27, 2004

D- Partial Decision with Reasons - August 31, 2004

5. DEFERRED TAXES (ISSUE 12.1)

5.1 BACKGROUND

5.1.1 The Board has been asked to rule on what amount should be recoverable from ratepayers following the Board's RP-2002-0135 Decision and Order on deferred taxes dated December 3, 2003 (the "135 Decision"). In the 135 Decision, the Board found that the Company is entitled to recover an amount from the notional utility account, as follows:

> "The Board finds and orders that EGDI is entitled to recover from the notional utility account an amount, after taxes, equal to the deferred taxes that became payable between October 7, 1999[1] (the date in which the assets were transferred out of EGDI to an affiliate) and May 7, 2002 (the date of the sale of the rental assets to a third party). EGDI may seek to recover such amount, appropriately verified, in its next rates application. The Board expects EGDI to ensure that its request for recovery includes consideration of any potential for rate shock." (135 Decision, para. 62)

[1] It appears that the date should have been written as October 1, 1999 rather than October 7, 1999. Parties to the RP-2003-0203 proceeding have assumed that October 1, 1999 was the correct date.

5.1.2 In response to the Board's finding and order, the Company filed evidence in support of a claim of $23,873,850 ("$23.9 million"), after taxes, to be recovered over a two-year period starting in fiscal 2005. The Company stated that the $23.9 million represented the amount of deferred taxes that became payable during the period October 1, 1999 and May 7, 2002 in relation to the transferred rental assets that were resident in 3696669 Canada Inc. ("Rentco"). Rentco had been established for the purpose of holding the transferred rental assets after the Utility unbundled its ancillary programs on October 1, 1999.

5.1.3 The rental program deferred taxes matter has a lengthy procedural history. The Board has issued two key decisions on the matter. The first was the E.B.O. 179-14/15 Decision dated March 31, 1999 (the "179 Decision"). The second was the 135 Decision.

5.1.4 The Board will refer only to those parts of the historic record that are relevant to the current issue in this case, that being the amount of deferred taxes recoverable. In other words, the Board does not intend to embark on a lengthy description of all the events leading up to this decision. Anyone wishing to refer to the full record can access it through dockets E.B.O. 179-14/15, RP-2002-0135 and the current proceeding, RP-2003-0203.

5.2 POSITIONS OF THE PARTIES

5.2.1 The Company's position is summarized as follows.

- Prior to the unbundling of the group of ancillary programs on October 1, 1999, the gas utility owned a group of rental assets. At that time, the Utility's business activity of renting this group of assets was referred to as the "rental program," and it was determined by the Board to have provided benefits to gas ratepayers through lower gas distribution rates in the amount of $50 million.

- At the same time, the Company was aware that a significant amount of unrecorded deferred taxes had accumulated in respect of this group of assets. In the 179 Decision, the Board decided that by way of the notional utility account, recognition should be given to the benefits provided to gas ratepayers and that up to $50 million could be drawn from the notional utility account to pay deferred taxes as they became due.

- EGDI interpreted the Board's 179 Decision as referring to the benefits provided by the group of rental assets held in the Utility prior to unbundling, and further that when the Board spoke of deferred taxes becoming due, it was referring to deferred taxes in respect of that same group of rental assets.

- The Company's view was that with a particular group of assets such as the group of rental assets that were formerly owned by the Utility, the amount and timing of the deferred taxes becoming payable can be calculated by comparing book depreciation to capital cost allowance.

- The Company asserted that the calculation is not complicated and that the amount of deferred taxes that became payable between October 1, 1999 and May 7, 2002 was $23.9 million. EGDI emphasized that this was the amount in respect of the particular group of rental assets, referred to as the utility's rental program.

- In the Company's view, no party has cast any doubt on the $23.9 million, or pointed out any obfuscation in the Company's presentation of the figure.

- The Company also asserted that the $23.9 million in deferred taxes payable is entirely consistent with all of the decisions that the Board has issued on the deferred taxes subject to date.

5.2.2 Intervenors making submissions included CAC, CME, Energy Probe, IGUA, SEC and VECC. These parties advanced a number of arguments with respect to the appropriate amount for recovery from ratepayers. The arguments included various interpretations of Board decisions and of alternative approaches to the treatment of taxes. Collectively, and in summary form, the Intervenors' substantial arguments are set out below:

- They argued that the rental business being carried out in Enbridge Services Inc. ("ESI") and Rentco should be treated as one enterprise for the purposes of determining the deferred tax amount because in practice, it is a single business. Before it was sold to Centrica plc, the ESI business was being operated as an ongoing business with new asset additions while the Rentco business contained a static pool of assets. With no asset additions, the deferred tax crossover was achieved at an artificially early date within Rentco.

- The Board should ensure that ratepayers get credit for the $42 million tax refund that the Board directed to the shareholder's account in its 179 Decision.

- The Board should consider the recovery amount in the context of the actual taxes paid by Rentco, which was about $10.9 million. The actual taxes paid should constitute a cap on the recovery amount.

- The Board should ensure that ratepayers get credit for tax savings, outlined in the ESI tax plan that were ignored so that ESI could save $2.7 million in capital taxes. Those tax savings were identified to have been $11 million.

- Intervenors also argued that the Board should take into account the gain from the sale of the rental business to Centrica plc, because the Board specifically mentioned the prospect of a sale to a third party as a potential outcome in its 179 Decision. In view of the fact that the gain from this sale overshadowed the deferred tax recovery, the Board should therefore apply the proceeds in its consideration of any recovery.

5.3 BOARD FINDINGS

5.3.1 In previous proceedings the Board has already heard and decided a number of the substantive arguments put forward by Intervenors in connection with the deferred taxes issue. What is different this time is that the Board has the advantage of historic financial data.

5.3.2 The key decisions or principles set out in past Board decisions that are relevant to the question of the amount of deferred taxes payable by Rentco are set out below:

1) The Company may seek to recover up to $50 million to pay deferred taxes associated with the rental program assets as they become due. (179 Decision, para. 3.3.19) The Board confirmed this in the 135 Decision, para. 59.

2) The $42 million credit arising from the Supreme Court's 1998 decision on expensing versus capitalizing the rental program installation costs belongs to the shareholder. (179 Decision, para. 3.3.11)

3) The Board accepted that the deferred taxes payable should be assessed from the perspective of Rentco alone, and not in combination with other affiliated companies. (135 Decision, para. 60)

4) The Board confirmed the entitlement of the Company to collect the deferred taxes that became payable for Rentco between the relevant dates. (135 Decision, para. 62)

5.3.3 The Board has carefully considered all of the evidence put forward by the Parties on this issue. The Board relies on the guidance provided in past decisions on this subject and this guidance fundamentally settles much of what is being disputed. Although the Board is not bound by previous decisions, they have a high degree of persuasive value. Many of the arguments put forward in this case are either subsumed or become irrelevant if these previous decisions are relied upon and applied.

5.3.4 The Board is not convinced that the additional evidence available in this proceeding would have caused a different outcome in the 135 Decision or the 179 Decision had it been available at that time.

5.3.5 Nevertheless, the Board believes that it would be instructive to provide additional clarity on three points, namely, the combination issue, the gain on the sale of the business issue, and the issue respecting the $42 million tax credit.

5.3.6 Confirming the 135 Decision, the Board finds that it is not appropriate to consider the tax deductions contributed by other affiliates as an offset to the taxes payable by Rentco. The ratepayer was not entitled to benefit from the tax deductions attributable to affiliate losses, since those tax deductions were not related to the rental program and the parent could have chosen a different time or way to capture them. In the specific case of the $11 million tax savings, outlined in the ESI tax plan as referred to by SEC, the Board is further comforted by the Company's evidence that the $11 million savings was only a matter of timing and that there were no permanent savings available from that transaction.

5.3.7 The second point for clarification is the treatment of the gain on the sale of the business to Centrica plc and whether that gain should be considered in reducing, or eliminating, the deferred taxes payable. The Board has decided that a reduction is not appropriate because the Board's 135 Decision confirmed the entitlement of the Company to collect the deferred taxes. The Board made its decision in the 135 case with full knowledge of the Centrica plc transaction, and chose to confirm the Company's entitlement to a draw from the notional utility account notwithstanding the same.

5.3.8 Intervenors argued that the $42 million tax credit should not be allocated to the shareholder because the liability had been transferred to the new owner of the assets as a result of the sale. The 179 Decision established that the shareholder was responsible for the overall deferred tax liability. The Board notes that the recovery of the deferred taxes payable from October 1, 1999 to May 7, 2002 does little to reduce this liability. The fact that future liability for deferred taxes was transferred with the sale of the rental assets to a third party is irrelevant as, presumably, this liability impacted the sale price. Therefore, the Board confirms that the $42 million tax credit belongs to the shareholder.

5.3.9 In view of guidance provided in past Board decisions, the only question left for the Board is to determine then, is what amount represents "the deferred taxes that became payable" between the two relevant dates.

5.3.10 The Board finds that the Company has complied with the guidance provided by the Board in the 179 Decision and the 135 Decision. Further, the Board finds that the Company's actions were reasonable in view of the Board's directives.

5.3.11 In the Board's opinion, none of the intervening parties was able to credibly refute the calculation of the $23.9 million as being the number "equal to the deferred taxes that became payable" between the two relevant dates, and that was ordered by the Board in the 135 Decision. The Company outlined its methodology in some detail in its prefiled evidence.

5.3.12 It appears to the Board that the $23.9 million figure accurately represents "the deferred taxes that became payable between October 1, 1999 (the date in which the assets were transferred out of EGDI to an affiliate) and May 7, 2002 (the date of the sale of the rental assets to a third party)". The Board therefore finds that the Company is entitled to collect $23.9 million from its ratepayers.

5.3.13 The Company may recover $23.9 million, after taxes, in equal installments, over a three-year period commencing in fiscal 2005. The Company shall not recover interest on the balance in 2005, but may do so for the residual balance in future years. However, any interest recovery is applicable only to $23.9 million which represents the after tax amount. The Company is hereby authorized to set up a deferral account for this purpose.

5.3.14 The Board finds that the three-year recovery period is appropriate to mitigate rate shock and to match the roughly three-year period in which the deferred taxes payable were generated.

5.3.15 The Board considers that this ruling on the recovery amount brings finality to this issue.

TAB 5

Ontario Energy Board

Commission de l'Énergie de l'Ontario

Ontario

EB-2005-0449

NOTICE OF APPLICATION

UNION GAS LIMITED
RATES FOR 2006

Union Gas Limited ("Union") has filed an Application dated July 29, 2005 ("Application") with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Sched. B, as amended, for an order of the Board approving or fixing rates for the sale, distribution, transmission and storage of gas. The Board's decision on this Application may have an affect on all Union customers.

Union has proposed a change to its delivery rates which, if approved by the Board, would result in an increase of about $16.48 (or 1.4%) on a typical southern operations area residential customer's annual bill, an increase of $23.41 (or 1.8%) on a typical northern operations area residential customer's annual bill and an increase of $23.67 (or 1.8%) on a typical eastern operations area residential customer's annual bill. The rate change would take effect on January 1, 2006.

The Board will deal with any changes to the commodity cost of natural gas for customers that purchase gas directly from Union through the Quarterly Rate Adjustment Mechanism.

Copies of the Application and the supporting written evidence are available for inspection at the Board's office and Union's office at the addresses indicated below.

Participation

You may participate in this proceeding in one of three ways:

1. You may send the Board a letter of comment. Your letter should include any request to make an oral presentation to the Board, and must be received by the Board no later than 30 days from the publication date of this notice.

2. You may request observer status in order to receive documents issued by the Board in the proceeding. Your request must be made by letter received by the Board no later than 10 days from the publication date of this notice.

3. You may request intervenor status if you wish to actively participate in the proceeding. Your request must be made by letter of intervention received no later than 10 days from the publication date of this notice. Your letter of intervention must include a description of how you are, or may be, affected by the proceeding; and if you represent a group, a description of the group and its membership. The Board may choose to hold either a written or an oral hearing. The Board will not hold a written hearing if a party satisfies the Board that there is good reason for holding an oral hearing. Your letter of intervention should indicate your preference for a written or oral hearing, and the reasons for that preference. The Board may order costs in this proceeding. You must indicate in your letter of intervention whether you expect to seek costs from the applicant and the grounds for your eligibility for costs. You must provide a copy of your letter of intervention to the applicant.

Need more information?

Further information on how to participate may be obtained by visiting the Board's Web site at www.oeb.gov.on.ca or by calling our Consumer Relations Centre at 1-877-632-2727.

How to contact us

In responding to this notice please reference Board file number EB-2005-0449. It is also important that you provide your name and postal address and, if available, an e-mail address. All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

For your convenience, the Board accepts letters of comments by either post or e-mail. Our e-mail address is Boardsec@oeb.gov.on.ca Please include the application file reference number in the subject line of your e-mail.

Letters of intervention must be sent by regular mail to the address below. Please remember that you must send a copy of your request for intervention to the applicant at the address listed below.

Procedural matters

Those parties that intend to participate in this application should be informed that the Board intends to hold an oral hearing on several procedural matters dealing with this

Application. This hearing will take place at the Board offices on Sep 20 and 21 commencing at 9:30 a.m. The applicant and registered intervenors should be prepared to address two questions at that time. These are:

1. Does the material filed by Union Gas form a sufficient evidentiary base from which to evaluate the company's revenue requirement for 2006?
2. If not, what alternative approaches could be used to determine an appropriate rate adjustment, if any, for 2006? The Board is seeking comment on potential options for indexing existing rates for 2006.

Ce document est disponible en français.

ADDRESSES

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Union Gas Limited
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Toronto, Ontario N7M 5M1

Attn: Bryan Goulden
Manager, Regulatory Applications

Tel: 519-436-4637
Fax: 519-436-4641
Email: bgoulden@uniongas.com

IF YOU DO NOT FILE A LETTER STATING YOUR WISH TO PARTICIPATE IN THIS PROCEEDING, THE BOARD MAY PROCEED WITHOUT YOUR PARTICIPATION AND YOU WILL NOT BE ENTITLED TO FURTHER NOTICE OF THE PROCEEDING.

DATED at Toronto, August 26, 2005.

ONTARIO ENERGY BOARD

John Zych
Board Secretary

Ontario Energy Board | Commission de l'Énergie de l'Ontario

Ontario

EB-2005-0449

IN THE MATTER OF the *Ontario Energy Board Act,*1998, S.O. 1998, c.15 (Sched. B);

AND IN THE MATTER OF an Application by Union Gas Limited, pursuant to section 36(1) of the *Ontario Energy Board Act,* 1998, for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission, and storage of gas as of January 1, 2006;

BEFORE: Paul Sommerville
Presiding Member

Cynthia Chaplin
Member

Cathy Spoel
Member

DECISION ON MOTION

October 13, 2005

Union Gas Limited ("Union") filed an application (the "Application") dated July 29, 2005 with the Ontario Energy Board (the "Board") for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission, and storage of gas commencing January 1, 2006. The Board assigned file number EB-2005-0449 to the Application.

In particular, the Application sought Orders from the Board permitting Union to: (1) increase existing rates by 5.4%, commencing in 2006, and (2) continue the earnings sharing mechanism, currently in place for 2005, into 2006.

On August 26, 2005, the Board issued a Notice of Application which included directions on how to participate and which was published throughout Union's service territory. As part of the Notice, the Board set September 20 and September 21, 2005 as the dates to hear several procedural matters. Participants were asked to be prepared to answer the following questions:

1. Does the material filed by Union Gas form a sufficient evidentiary base from which to evaluate the company's revenue requirement for 2006?

2. If not, what alternative approaches could be used to determine an appropriate rate adjustment, if any, for 2006? The Board is seeking comment on potential options for indexing existing rates for 2006.

In a written submission dated September 15, 2005, Union addressed the Board's two questions and proposed that an index-based approach could be used for rate setting for the 2006 calendar year. This proposal effectively replaced Union's original Application for a 5.4% increase with an alternative proposal that carried a lower percentage increase while still including the continuation of the current earnings sharing mechanism.

On September 20, 2005, upon canvassing the parties present at the hearing, the Board convened a settlement conference for the balance of the day to assess the prospects for a settlement of the issues amongst the parties. On September 21, 2005, the Board was informed that no settlement could be reached. Consequently, the Board proceeded to hear submissions from the parties on the two questions.

At the hearing, Union informed the Board that it intended to amend its Application and that it would file supplementary evidence to provide for its alternative index-based rate setting approach. To this end, Union filed an amended application, together with supplementary information, on September 23, 2005. The amended application requested that as an alternative to the original 5.4% increase, an index-based adjustment mechanism of 2%, based on Ontario CPI, be used to set 2006 rates and that a further allowance of 0.6% be added for Union's Workforce Development and Enhancement Initiative (WDEI) for a total increase of 2.6%.

BOARD FINDINGS

With respect to the first question posed in the Board's Notice, the Board concurs with the parties and finds that the evidence filed to date does not represent a sufficient evidentiary basis to proceed with a cost of service approach to rate setting for 2006. The Board also notes Union's statement that the information for a traditional cost of service review does not exist and therefore cannot be provided in the time frame required for rates to be approved by January 1, 2006.

The Board must therefore decide whether an alternative approach to rate setting, if any, is warranted. Union has proposed a formulaic approach using the Consumer Price Index ("CPI"), with an additional adjustment to account for costs related to its aging workforce. Union submitted that timing pressures and the prima facie evidence of increased costs provide sufficient grounds for the Board to consider such an approach. Other parties challenged Union's approach and some proposed other index-based approaches, including Union's prior approved PBR adjustment mechanism.

While the Board has traditionally used a cost of service approach to rate setting, the OEB Act does not require the Board to take this or any other specific approach to determine whether rates are just and reasonable rates. However, any approach taken by the Board requires a sufficient evidentiary basis for the Board to make an informed decision in the particular circumstances of each case that the rates set by the Board are just and reasonable.

The Board has used an index-based adjustment process to approve rates in two circumstances: to allow Enbridge to have its rates approved in a timely fashion following several years of retroactive approvals, and as part of a broader PBR process. In the Board's view, neither circumstance applies to Union's current situation. Obviously, an adjustment is not being considered within the context of a broader PBR or incentive regulation process, and therefore the latter approach is not relevant. The circumstances around the Enbridge approach require further consideration.

There were two specific circumstances surrounding the Enbridge approach that are relevant. First, the adjustment mechanism for Enbridge was designed to address a particular set of extraordinary circumstances, namely to bring Enbridge "back on track" to an appropriate regulatory schedule. Second, the index-based adjustment was applied to rates which had quite recently been subject to a thorough cost of service review.

Neither circumstance applies to Union in this case. The fact that Union plans to file its full cost of service evidence for 2007 rates in December of this year makes the position even more difficult. Once this evidence is filed, the rationale for an indexing approach weakens considerably.

The Board understands the pressures imposed by the regulatory agenda; however, it is up to Union to resource itself appropriately so that it may achieve its priorities. It is inappropriate to seek to abbreviate the proceeding or justify an index-based approach solely on the basis of timing concerns. Further, Union seeks to apply the adjustment to 2005 rates, which are, in turn, adjusted 2004 rates. A substantial period of time has elapsed since a cost of service review has been conducted. This raises a number of substantive issues about the appropriate base for any index-based adjustment, which requires additional evidence beyond that which Union has provided to date. General evidence of cost pressures and a possible revenue deficiency in a future year are not sufficient grounds on their own to support a formulaic adjustment approach, particularly given that the evidence filed to date indicates a revenue sufficiency for 2005.

It is noteworthy that since Union's last cost of service application, which was heard in late 2003 for 2004 rates, the Company has earned substantially more than the regulated rate of return.

If Union wishes to pursue this application it would be necessary, at a minimum, for it to provide evidence addressing the following:

- Adjustments to the 2005 rates to set the base for any formulaic adjustment (including consideration of long term debt rates, return on equity, and excess earnings levels in 2005)
- Alternative formulas/indices (including GDPPI, productivity factors, input price adjustments)
- Adjustments for particular factors (including WDEI and the recent merger between Duke and Cynergy)
- Structure of the earnings sharing mechanism
- Application of the adjustment (including whether the adjustment is before or after the Delivery Commitment Credit (DCC) adjustment, and whether the adjustment should be applied to the fixed and/or variable portions of the rate)

In providing guidance to the Parties, the Board is motivated by pragmatic considerations as well as issues of regulatory principle. As a matter of regulatory principle, the Board concludes that the amended application, as it stands, does not meet a reasonable standard of completeness. With respect to more pragmatic considerations, the Board notes Union's explicit desire to preserve the timing of both the Natural Gas Forum processes and its own 2007 rates case. While the 2006 process might be expedited to some extent, the Board concludes that setting new rates for January 1, 2006 is not achievable, given the evidentiary requirements and the timing criteria established by

Union. The Board further notes that adjusting rates on a retroactive basis can be problematic, and raises separate issues.

The Board understands the concerns expressed by parties on DSM and fuel switching issues. Intervenors submitted that the Board should direct Union to file its 2006 DSM plan and related materials by October 31, 2005, and to order that fuel switching issues be addressed in the DSM process. Given Union's stated commitment to meet the specified date and to accept fuel switching issues as part of that process, the Board finds that no order is required. Further, given that the DSM process is a separate process in any event, the Board will not order Union to prepare evidence related to the questions raised by Pollution Probe. However, the Board notes that, as discussed above, if Union wants to expedite the process, it would do well to consider the requests of Pollution Probe and address them on a proactive basis.

If Union decides not to proceed with its application as amended, it must still prepare a rate order for 2006 which should include the further implementation of the DCC reduction and a continuation of the earnings sharing mechanism.

The Board will determine awards of costs associated with this Decision as part of an overall determination of costs for the Application. Eligible intervenors shall submit any costs claims as soon as possible.

DATED at Toronto, October 13, 2005.

ONTARIO ENERGY BOARD

Signed on behalf of the Panel

Original Signed By

Paul Sommerville
Presiding Member

TAB 6

Ontario Energy Board
Commission de l'Énergie de l'Ontario

VT INCEPIT FIDELIS SIC PERMANET
Ontario

EB-2005-0551

NATURAL GAS ELECTRICITY INTERFACE REVIEW

DECISION WITH REASONS

November 7, 2006

EXECUTIVE SUMMARY

INTRODUCTION

This proceeding was initiated by the Ontario Energy Board in late 2005 in response to issues first raised in the Board's *Natural Gas Forum Report* and more fully explored in the OEB staff report, *Natural Gas Electricity Interface Review*. The key issues addressed in this proceeding were:

- Rates and services for gas-fired generators
- Storage regulation.

The hearing participants, which included gas-fired generators and consumer groups, reached settlements with Union Gas Limited (Union) and Enbridge Gas Distribution Inc. (Enbridge) on most of the issues related to services for gas-fired generators, and the Board has approved those settlements. The oral hearing and this Decision addressed the issues which were not settled and the issue of storage regulation.

SERVICES FOR GAS-FIRED GENERATORS

The need to examine new services for gas-fired generators arises because of the increasing number of so-called "dispatchable" gas-fired power generation plants that are planned or in operation. These plants operate in response to five-minute dispatch instructions from the Independent Electricity System Operator (IESO), and, as a result, their gas consumption profiles are more volatile and difficult to forecast than the relatively stable profiles of residential, commercial and industrial gas consumers. Flexible and responsive gas services, including high-deliverability gas storage, can ensure the reliable operation of these plants and allow the plant operators to manage the financial risk of the business.

Union's existing storage capacity is well in excess of the current needs of its in-franchise customers and has been for many years. The Board has decided that Union will reserve approximately two-thirds of its existing capacity for in-franchise needs. At current rates of growth, that amount limit will satisfy in-franchise needs for several decades. Enbridge currently purchases storage from Union for a portion of its requirements. The Board has decided that Union will continue to provide these services at cost through a transition period ending in 2010.

Sharing the Premium on Ex-Franchise Sales

The sale of storage services by Union and Enbridge at market-based rates to ex-franchise customers has generated revenues well in excess of the cost of providing those services. Until now, the Board has required that most of the profits be used to reduce distribution rates. The Board has concluded that this sharing should continue for short-term storage deals. These are storage transactions that use storage space that is temporarily surplus to in-franchise needs. All of the profits on these transactions, less small incentive payments to the utilities, will be for the benefit of ratepayers.

The Board finds, however, that Union will not be required to share the profits on long-term storage transactions that use storage space not needed to serve in-franchise needs because that capacity now constitutes a "non-utility" asset for which the shareholders appropriately bear the risk. The sharing of these profits will remain unchanged for 2007 and then be phased out over the period to 2011.

Impact on Consumers

The Board's decisions are expected to have virtually no effect on consumers' bills in 2007. The impact after that cannot be precisely quantified because it will depend on future storage prices, the profit on ex-franchise storage sales, and the amount of gas consumed. While a precise forecast is not possible, bills are likely to increase by a small amount – perhaps around 1% for the typical residential consumer.

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the utilities provide storage to their regulated business through these investments, the ratemaking implications of that approach will be considered in the context of a rates proceeding.

5.2.4 Forbearance in the Ex-Franchise Market

Most parties argued that ex-franchise customers should pay market-based rates. Some parties took the position that the Board could refrain from regulating the prices in this market (if the Board determined the market was competitive), and others were of the view that the Board should continue to approve market-based range rates.

For example, the Consumers Council argued that the Board should not refrain from regulating storage but that it is appropriate for the utilities to charge market rates for Transactional Services and long-term storage services to maximize revenue from the assets for the benefit of ratepayers.

Board Findings

The evidence shows that other than for in-franchise customers, the storage market is competitive. With the exception of Enbridge, the customers in this competitive part of the market (commonly referred to as ex-franchise) have been acquiring storage at market-based rates for some time. The Board sees no benefit from continuing to regulate the prices of these services; on the contrary, competition in this area is sufficient to protect the public interest. The Board will therefore refrain from regulating rates or approving contracts for Union's short- or long-term ex-franchise storage services and will refrain from regulated the rates or approving the contracts for Enbridge's Transactional Storage Services.

5.2.5 Separation of Unregulated Storage Costs and Revenues

Both Union and Enbridge proposed to separate the unregulated costs and revenues from the regulated costs and revenues using a cost allocation study. The issue is whether a cost allocation approach is sufficient, or if a greater degree of separation is required. Further, if a cost allocation approach is sufficient, there is an issue as to whether Union's current cost allocation study is adequate.

During the oral hearing, Union's witnesses indicated that Union would be preparing a new cost allocation study as the basis for revising the allocation of the costs of its storage assets between in-franchise (regulated) and ex-franchise (unregulated). In its final argument, however, Union submitted that the cost allocation necessary to split the costs of its storage assets between in-franchise and ex-franchise has already been completed in its 2007 rates case. According to Union, that allocation would result in the total storage rate base being split as follows ($ million):

Included in regulated rate base	$380.703	(79%)
Allocated to ex-franchise activities	$102.916	(21%)
Total	$483.619	(100%)

Enbridge proposed to separate the costs and revenues associated with its Transactional Storage Services at the next rates proceeding. It was Enbridge's position that no adjustment to rate base would be required if the Board were to forbear from price regulation.

Some parties argued that a greater degree of separation was required; others argued that Union's cost allocation study was inadequate.

Energy Probe argued that accounting separation is not sufficient because the historic cost allocation work could not have anticipated the dramatic change of storage forbearance. It took the position that the Board should encourage full structural separation at least, and that ratepayers should be held harmless for any associated costs.

The Board Hearing Team also recommended that Union's transmission and storage operations should be functionally separated, and that both Union and Enbridge's regulated and non-regulated storage should be functionally separated. The Board Hearing Team was of the view that this separation is necessary to ensure the development of the competitive storage market and to encourage new entrants. However, if no separation were required, the Board Hearing Team suggested that there should be a generic cost allocation review to examine the cost allocation thoroughly and to ensure no cross-subsidization.

LIEN argued that it would be difficult to separate costs for Union's integrated storage business. In LIEN's view, the current cost allocation study may be adequate to set rates, but it is not sufficient to separate price-regulated storage from non-price-regulated storage. LIEN proposed that an alternative would be to transfer assets which are surplus to distribution needs to a separate entity at fair market value which, in LIEN's view, would put Union on an equal footing with other storage providers.

Similarly, LPMA/WPSPG argued that Union's current cost allocation is not necessarily appropriate; there may be fundamental methodology issues to be addressed and there are storage-related costs that are included in distribution costs that should be considered for allocation to Union.

Board Findings

The Board finds that functional separation is not necessary. The evidence before the Board is that it would be costly and difficult to establish a functional separation of utility and non-utility storage, and there was no evidence to suggest that there would be significant benefits from such a separation. To the extent there may be concerns regarding the integrated operations, these will be addressed through the reporting requirements set out in section 5.4.

We also conclude that Union's current cost allocation study is adequate for the purposes of separating the regulated and unregulated costs and revenues for ratemaking purposes. The Board agrees with the Board Hearing Team that it is important to ensure that there is no cross-subsidization between regulated and unregulated storage. However, the Board is content that with its findings on the treatment of the premium on short-term storage services (Chapter 7) Union will have little incentive to use the cost allocation for purposes of cross-subsidy.

The issue of Enbridge's cost allocation is addressed in Chapter 7.

5.3 CONCLUSIONS ON FORBEARANCE

In the previous sections, the Board has found that it will refrain, in part, from regulating storage rates under section 36 (as that section relates to storage) of the *OEB Act* and refrain from approving certain storage contracts under section 39(2) of the *OEB Act*. Specifically:

- The Board will refrain from regulating the storage rates or approving the contracts of new storage providers.
- The Board will continue to regulate storage rates for bundled, unbundled and semi-unbundled customers of Union and Enbridge (up to the allocated amount).
- The Board will refrain from regulating the storage rates or approving the contracts of cross-franchise, or ex-franchise, storage customers of Union and Enbridge.
- The Board will refrain from regulating the rates or approving the contracts for new storage services offered by Union and Enbridge.

5.4 REPORTING

A number of parties made recommendations regarding ongoing reporting by utilities and other storage operators. The utilities and their affiliates generally agreed to provide the type of reporting required by FERC for interstate pipelines (FERC Regulations, §284.13) although to some extent they challenged whether it was necessary. FERC Regulation §284.13 contains requirements for regular reporting on customer and system information.

Kitchener suggested that the Board develop a Storage and Transportation Access Rule or "STAR" to ensure non-discriminatory access to storage and transportation services, following on from the Gas Distribution Access Rule.

The Board Hearing Team identified four principles in this area:

- Create a level playing field for market participants,
- Adopt rules and practices to govern affiliate behaviour that protect the public interest,
- Support open and non-discriminatory access to transmission, and
- Establish a transparent storage/transmission market so market participants can make informed decisions.

The Board Hearing Team supported the development of a STAR. It also proposed that the ARC be amended to control the interaction between the utilities and their storage affiliates and that reporting requirements be put in place for all storage providers in order to enhance transparency in the market.

Board Findings

The Board agrees with the Board Hearing Team's principles and shares the concerns related to forbearance raised by a number of parties. Specifically, in refraining from regulating storage rates or approving storage contracts, the Board must:

- Ensure consumer protection within the competitive market for storage in Ontario.
- Ensure access to Union's transportation system on a non-discriminatory basis to new and existing storage operators.

The Board concludes that it is necessary to develop appropriate operating and reporting procedures to ensure these objectives are addressed. The Board finds that Kitchener's proposal for the development of a STAR (Storage and Transportation Access Rule) has merit.

The Board will initiate a process to develop rules of conduct and reporting related to storage. The Board will ensure that the process addresses the following:

- Requirements to ensure that Union cannot discriminate in favour of its own storage operations or those of its affiliates and cannot discriminate to the detriment of third-party storage providers;
- Reporting requirements for all storage providers, although the requirements may vary as between utility and non-utility storage providers, and which may include: terms and conditions, system operating data, and customer information;
- A complaint mechanism for customers (or other market participants).

6. ALLOCATION OF STORAGE AVAILABLE AT COST-BASED RATES

Having decided that Union and Enbridge should retain regulated, cost-based rates for storage used by in-franchise customers, the question becomes how much of the existing storage space should be reserved for those customers. There are two issues arising from this allocation matter.

First, should the amount of storage available to Union's in-franchise customers at cost-based rates be fixed at an amount less than the total working gas capacity of Union's storage pools, currently 152 Bcf? Union proposed to fix the amount of existing storage allocated to in-franchise customers at the amount Union estimates those customers will use in 2007.

Second, what method should Union and Enbridge use to allocate the amount of storage available at cost-based rates to individual unbundled and semi-unbundled customers? The evidence shows that, for various reasons, many of Union's T-service (semi-unbundled) customers have been allocated amounts of storage that are inconsistent with amounts determined under Union's standard "aggregate excess" method. In addition, Kitchener argued that as a gas distributor embedded in Union's distribution system, it requires more storage space at cost-based rates than the amount calculated under the aggregate excess method.

6.1 UNION'S TOTAL COST-BASED STORAGE ALLOCATION

Union proposed to freeze, on January 1, 2007, the amount of its storage capacity available to in-franchise customers at cost-based rates. The frozen amount would be 92.1 PJ (approximately 87 Bcf), Union's estimate of in-franchise requirements for 2007.

Incremental in-franchise storage requirements due to load growth would be met by Union purchasing the required additional amounts in the market and passing through the contract costs to its in-franchise customers.

Union noted that the in-franchise storage requirement has been very stable over the past seven years, increasing from 88.2 PJ in 2000 to 90.6 PJ in 2006, an annual growth rate of just 0.45%.

In its evidence, Union explained the rationale for its proposal as follows:

> Under the current regulatory framework, any future increase to in-franchise storage requirements would be provided through a reallocation of the portfolio of storage capacity owned and managed by Union.
>
> This current practice is not appropriate as it does not reflect the fact that the storage market is competitive, nor does it encourage or support the development of new storage capacity. Specifically, Union would not be incented to assume the risk and commit the capital and resources to develop new storage capacity with economics premised on competitive market pricing, when there is a risk of this storage being reallocated in the future to meet in-franchise requirements at a cost of service rate.[35]

In argument, Union summarized the reasons for its proposal as follows:

- "Claw-back" of assets etc. allocated to ex-franchise sales would undermine development of new storage capacity premised on market pricing.
- "Claw-back" would also make cost allocation issues more complex.
- Meeting incremental demand with services sourced from competitive markets is consistent with a transition to competition and a step toward sending better "price signals" to in-franchise customers.
- This proposal will not result in "rate shock" of any kind.[36]

Kitchener, LPMA/WGSPG, Consumers Council, VECC, and IGUA/AMPCO argued that there should be no freeze on the amount of Union's storage available at cost-based

[35] Union Pre-filed evidence, Exhibit C, Tab 1, page 15.
[36] Exhibit Y2.1, outline of Union reply argument, page 4.

rates to in-franchise customers. GMi and the Board Hearing Team supported Union's proposal.

Board Findings

Under the existing regulatory framework, Union's in-franchise customers have had first call, at cost-based rates, on Union's storage capacity. Said differently, Union has sold storage services to ex-franchise customers only when it can demonstrate that the storage being sold is surplus to in-franchise needs.

From an operational perspective, it is not necessary (nor would it appear to be feasible) for Union to physically split its storage facilities between "in-franchise" and "ex-franchise" uses. And until now, Union has been able to offer storage services in the ex-franchise market without capping or freezing the amount of capacity that is available for in-franchise uses.

Giving in-franchise customers a priority call at cost-based rates on all of Union's storage may be supportable if one takes the view that every Bcf of Union's storage capacity is a "utility asset" and is required to provide "utility services." But that view needs to be re-examined in light of the evidence presented at this hearing about the development and use of Union storage in recent years, and the Board's determination that the storage market is competitive.

Amount of Union's "surplus" capacity

There is no doubt that Union's existing storage capacity far exceeds the current requirements of its in-franchise customers. Some 40% of the current capacity has been sold in the ex-franchise market. And the requirements of in-franchise customers have grown slowly (less than 0.5% per year over the past six years according to Union's evidence). The excess is so large that it would take several decades for all of the current capacity of 152 Bcf to be required for in-franchise customer needs if those needs grow at 1% per annum, and more than 100 years at the current rate of growth.

In past decisions on storage, the Board has required Union to file forecasts of storage capacity and in-franchise needs to demonstrate that space being sold to ex-franchise customers is surplus to in-franchise needs. For example, in the EBRO 494-03 decision, the Board approved four long-term ex-franchise storage contracts based on Union's 10-year forecast of capacity and in-franchise needs. The Board considered, but did not require, Union to insert a clause into the contracts that would allow Union the right of recall because the Board "found...that the Company's forecast of its in-franchise storage needs is reasonable."[37]

Union's storage development

During the hearing, a common argument from many parties on several different issues (particularly on the issue of sharing the premium on ex-franchise sales) was that in-franchise customers have "paid for" or "substantiated" the storage assets of the utilities. If true, is this a basis for continuing to grant in-franchise customers a perpetual call on all of Union's storage capacity at cost-based rates?

This argument breaks down on two fronts. First, Union's rate base excludes capital costs of storage that underpins long-term ex-franchise sales. Second, the sheer magnitude of the current surplus makes it unlikely that Union's expansion of its storage facilities in the recent past has been driven primarily, or perhaps even to any significant extent, by the anticipated needs of in-franchise customters. For example, since 1999 Union has added almost 18 Bcf of capacity through greenfield developments and enhancements to existing pools, capacity that was not necessary to cover in-franchise needs. This additional capacity has been directed to, and taken up by, the "ex-franchise" market, not distribution customers of Union.

Ex-franchise customers have contracted for Union's long-term surplus space and have paid market-based rates, rates that have been much higher than cost-based rates. Rather than bearing the costs of surplus Union storage space that is offered long-term

[37] EBRO 494-03 Decision with Reasons, September 26, 1997, paragraph 2.2.29.

to the ex-franchise market, Union's in-franchise customers have in fact benefited through receiving most of the premium on long-term sales.

Union's rationale

Union claims that development of new storage capacity would be undermined unless the amount of storage allocated to in-franchise customers is capped. This claim appears to have little merit. First, no party to this proceeding has opposed market rates for new storage capacity by third parties. Second, a freeze on space for in-franchise customers would have a neutral effect on the development of the competitive market. This was illustrated by LPMA/WGSPG, which put forward the following scenario in its argument: Assume the incremental storage requirement for the in-franchise customers is, say, 2 Bcf in a particular year. Under Union's proposal, Union would purchase that 2 Bcf from third-party providers. Under the existing framework, that 2 Bcf would be supplied by Union, leaving it with 2 Bcf less for ex-franchise sales. That 2 Bcf shortfall could be provided by third-party providers. The net impact on third-party providers is 2 Bcf of additional storage in either case.

Union also claims that meeting incremental in-franchise demand at market prices is consistent with a "transition to competition" and would send "better price signals to in-franchise consumers." No one in this proceeding, however, has advocated that any in-franchise customers, except for some of the largest gas customers, should be obligated to take a service that might require them to participate directly in the competitive storage market.

GMi, currently Union's largest ex-franchise customer, and Nexen expressed concerns about "claw-back" that the Board finds more compelling than Union's argument. GMi opposed any storage allocation rules that could result in "clawing back storage capacity held by ex-franchise customers for the benefit of in-franchise consumers." It said it would view any such measure as unfair discrimination. Nexen submitted that "claw-back" of storage services from ex-franchise customers would be "discriminatory and detrimental to not only GMi but to the very existence of the secondary market that Ontario currently supports and benefits from."

Conclusion

The Board finds that there should be a cap on the amount of Union's existing storage space that is reserved for in-franchise customers at cost-based rates. In the Board's view, Union's existing storage assets are, in substance, a combination of "utility assets" required to serve Union's in-franchise distribution customers and "non-utility assets" that are not required for regulated utility operations and that are sold in the competitive storage market. This distinction is supported by the significant excess of total capacity over in-franchise needs for the foreseeable future and by the fact that development in recent years has been driven by the ex-franchise market, not in-franchise needs. The Board does not accept IGUA/AMPCO's submissions that the entire amount of Union's storage is a "utility asset" and that ex-franchise customers (such as gas marketers and utilities in the U.S. Northeast) are buying "utility services" when they purchase storage from Union. The Board has determined that the ex-franchise market is competitive and that it will refrain from rate regulation or contract approval; these will no longer be "utility" services.

The Board concludes that its determination that the storage market is competitive requires it to clearly delineate the portion of Union's storage business that will be exempt from rate regulation. Retaining a perpetual call on all of Union's current capacity for future in-franchise needs is not consistent with forbearance. As evidenced by the arguments from GMi and Nexen, two major participants in the ex-franchise market, retaining such a call is likely to create uncertainty in the ex-franchise market that is not conducive to the continued growth and development of Dawn as a major market centre.

The Board concludes that it would be inappropriate, however, to freeze the in-franchise allocation at the level proposed by Union. Union's proposal implies that a distributor with an obligation to serve would be prepared to own, or to have under contract, only the amount of storage needed to serve in-franchise customers for just the next year. In the Board's view, it is appropriate to allow for some additional growth in in-franchise needs when determining the "utility asset" portion of Union's current capacity.

The Board acknowledges that there is no single, completely objective way to decide how much should be reserved for future in-franchise needs. The Board has determined that Union should be required to reserve 100 PJ (approximately 95 Bcf) of space at cost-based rates for in-franchise customers. This compares with Union's estimate of 2007 in-franchise needs of 92 PJ (87 Bcf). At an annual growth rate of 0.5% each year, which Union claims is the growth rate since 2000, in-franchise needs would not reach 100 PJ until 2024. The limit would be reached in 2016 if the annual growth is 1%; at a very annual high growth rate of 2% per annum, the 100 PJ limit would be reached in 2012.

The 100 PJ (95 Bcf) amount is the capacity that Union must ensure is available to in-franchise customers if they need it. Union should continue to charge in-franchise customers based on the amount of space required in any year. If Union's in-franchise customers require less than 95 Bcf in any year, as measured by Union's standard allocation methodology, the cost-based rates should be based on that amount, not on the full 95 Bcf reserved for their future use. Union will have the flexibility to market the difference between the total amount needed and the 95 Bcf reserve amount.

6.2 ALLOCATION OF COST-BASED STORAGE: METHODOLOGY AND APPLICATION

Union and Enbridge have developed methods of allocating cost-based storage space to their in-franchise customers – both bundled customers as a group, and individual unbundled and semi-unbundled (T1 and T3) customers. The amount allocated currently has two implications for customers:

7. TREATMENT OF THE PREMIUM ON MARKET-BASED STORAGE TRANSACTIONS

Union and Enbridge ratepayers have received a significant portion of the premium over cost-based rates that results from the sale of storage services to ex-franchise customers at market-based rates. Chapter 2 provided information on the magnitude of the margins in recent years and the basis on which these margins are shared between the utilities and ratepayers. Union's ratepayers have received 90% of the forecast margins related to both long-term ex-franchise sales (contract terms of two years or more) and short-term transactions (contract terms of less than two years). Ratepayers also receive 75% of any margins that are greater than forecast amounts. Enbridge ratepayers have received approximately 75% of Enbridge's Transactional Services margins.

Union proposed to end the sharing of long-term and short-term margins with ratepayers. Specifically, Union proposed that the Board adjust distribution rates effective January 1, 2007, to exclude all storage costs and revenues associated with ex-franchise sales from 2007 rates and to eliminate five existing storage and transportation deferral accounts that currently capture market-based margins in excess of amounts incorporated into rates. Union has forecast 2007 margins at $29.9 million (long-term) and $14.6 million (short-term).

Enbridge also proposed to end margin sharing with ratepayers. It is seeking approval to exclude revenues and expenses associated with Transactional Storage Services from its distribution rates commencing in 2007. All Transactional Storage Service revenues, forecast to be $5 to $6 million in 2007, would accrue to Enbridge. The costs to be excluded from distribution rates in 2007 would be some portion of the approximately

$800,000 of O&M costs of Enbridge's Transactional Services business. Enbridge proposed to continue to include the entire net book value of its storage facilities in rate base.

The Board Hearing Team and Energy Probe supported the Union and Enbridge proposals. LPMA/WPSPG, Consumers Council, LIEN, VECC, IGUA/AMPCO, and Schools generally objected to any change in how margins are shared.

7.1 MARGINS ON SHORT-TERM STORAGE TRANSACTIONS

During the hearing, most parties presented views on the rationale for requiring the utilities to credit most of their storage margins to ratepayers. Several parties opposing the Union and Enbridge proposal to cease margin sharing referred to earlier Board decisions that they believed supported margin sharing.

The Board first dealt with margin sharing in the context of Union's short-term storage services, which Union started to sell at market-based rates in 1989. In 1996, the Board considered essentially the same issue when Enbridge proposed to start marketing its Transactional Services more aggressively and retain some of the margin. The Board has expressed a consistent view that Union's short-term storage transactions and Enbridge's Transactional Services involve sales at market-based rates of services derived from <u>utility assets</u> that are temporarily surplus.

In its decision in EBRO 492, dated September 10, 1996, the Board stated:

> The Company [Enbridge] stated that the objective of offering transactional services is to make additional use in off-peak periods of the Company's physical and contractual storage and transportation assets <u>acquired in the first place to serve the in-franchise customers</u>. [Paragraph 3.3.2, emphasis added]
>
> The Board does not agree that an incentive to provide these services should be necessary, and notes that the Company has offered both peak and off-peak services, along with assignments and exchanges in prior years without

> the need for an incentive. However, the Board acknowledges that the Company does incur some risk associated with its participation in these activities, and finds that a 10 percent incentive will be adequate to address these modest risks. [Paragraph 3.3.30]

In 1997, the Board for the first time approved Union entering long-term storage contracts at market-based rates with ex-franchise customers. In its decision in EBRO 494-03 dated September 26, 1997, the Board described the basis for allowing Union's short-term transactions as follows:

> Short-term storage for ex-franchise customers has been marketed on the basis that it is <u>space required to provide in-franchise service</u>. Due to weather and other variables part of the space is temporarily surplus to in-franchise needs. Customers already pay the costs of this storage in rates. Any revenue from short-term sales of storage services that is beyond the direct marginal cost to provide the service is a benefit to in-franchise consumers. [Paragraph 2.3.19, emphasis added]

Board Findings

The Board concludes that its decision to refrain in part from regulating rates for storage services does not invalidate the basis for sharing margins with ratepayers on short-term deals. Union's short-term storage transactions and Enbridge's Transactional Services storage sales are sales of services derived from utility assets that are temporarily surplus to in-franchise needs. The Board concurs with VECC's final argument on this point:

> In Union's case, the assets underpinning the short-term storage and balancing services sold in the ex-franchise market are presently included in rate base. In the case of Enbridge, all of the assets underpinning their transactional services sold in the ex-franchise market are included in rate base. As stated earlier, VECC views it as highly inappropriate for the utilities to seek the entire margin associated with these assets given that they have been "substantiated" by captive ratepayers who have paid in rates for the full opportunity cost of the associated capital investment (including a fair return on equity) along with overhead costs and direct operational costs associated with providing the services. In VECC's view, the utilities should be required to provide a rationale for receiving any of the associated margins given their earlier mentioned obligation to optimize the use of utility assets. [Page 16]

Requiring the utilities to share these margins with ratepayers is not in any way inconsistent with a finding that the storage market is competitive. The basis for sharing these margins is the nature of the assets that underpin the transactions, not the prices at which the transactions occur.

The Board finds that the entire margin on storage transactions that are underpinned by "utility asset" storage space, less an appropriate incentive payment to the utilities, should accrue to ratepayers. Ratepayers bear the cost of that space through the regulated storage rates and should benefit from transactions that utilize temporarily surplus space. The Board finds that shareholders will retain all of the margin on short-term transactions arising from the "non-utility" storage space.

Short-term margins derived from "utility assets"

The decision to require Union to notionally divide its existing storage into two pieces – a "utility asset" (maximum of 100 PJ) and a "non-utility asset" (the balance of Union's capacity) is set out in Chapter 6. Union's storage facilities will not be physically split into two pieces and Union is likely to continue operating its storage assets in much the same way as it does today. Union presumably will determine its ability to execute short-term deals based on the amount of temporarily surplus space in the entire storage facility. As long as the utility and non-utility storage is operated as an integrated asset, it will not be possible to determine that any particular short-term transaction physically utilizes space from either the "utility asset" or the "non-utility asset."

Given the impossibility of physically linking a short-term transaction to a specific slice of storage space, the Board considered other methods of determining the amount of storage margins that should accrue to Union's ratepayers. The Board has decided that the calculation should be based on how the costs of the storage facilities are split between the utility and non-utility businesses. Specifically, Union's revenues in any year from short-term storage transactions, less any incremental costs incurred by Union to earn those revenues, should be shared by Union and ratepayers in proportion to Union's allocation of rate base between utility and non-utility assets.

As indicated in Chapter 5, the allocation is currently 79/21 utility/non-utility. Union's existing policy on what constitutes a short-term storage transaction will continue to apply. As and when Union requires more capacity for in-franchise needs (up to the 100 PJ cap) or adds storage capacity or enhances deliverability of its storage facilities, the cost allocation will presumably change. Once a revised cost allocation has been approved in a Union rates case, the basis on which margins on short-term storage transactions are shared will also change.

All of Enbridge's current storage assets (storage facilities and contracts) are required to serve its in-franchise customers. Thus, all of Enbridge's storage-related transactional services revenues today are derived from "utility assets." If and when Enbridge increases the capacity of its Tecumseh storage facilities, it will be necessary for the company to adopt a method of allocating storage-related Transactional Services revenues between utility and non-utility assets.

Incentive payments to utilities for short-term transactions

The Board has considered whether to continue allocating a portion of the margins from short-term transactions to the utilities as an incentive to optimize the use of the "utility assets" of each company.

The Board has decided that Enbridge should continue to share in margins on Transactional Services storage deals. Eliminating any sharing would leave Enbridge with no financial incentive to market temporarily surplus storage space. An incentive mechanism aligns Enbridge's interest with the interest of ratepayers. The size of the incentive is a matter of judgement and that issue has been debated in several past rates cases. The Board finds that the current 25% incentive is excessive given that ratepayers bear all of the costs of the existing storage assets. The Board believes a

10% incentive is sufficient. In the future, 10% of the storage component of Enbridge's Transactional Services revenue, less any incremental costs incurred by Enbridge to earn those revenues, will be for the account of Enbridge. The remainder will be for the benefit of ratepayers. As a result, Enbridge will not be required to separate its revenues and costs for Transactional Storage Services.

With respect to Union, an argument might be made that an incentive is not necessary. Union will receive margins from short-term storage deals that are deemed to arise from the "non-utility" portion of its storage facilities. Thus, Union will already be motivated to maximize the revenues on all short-term transactions. The Board has decided, however, that it would be appropriate for Union and Enbridge to be treated consistently and to each receive 10% of the net revenues deemed to arise from the "utility asset" portion of storage.

The Board is currently undertaking a process to determine a multi-year incentive ratemaking framework for Union and Enbridge. That process will address how best to implement the Board's findings on the sharing of short-term storage transaction margins within an incentive ratemaking framework. Enbridge's 2007 rates case is in progress; the Board's finding with respect to short-term margin sharing will be implemented through that proceeding.

7.2 MARGINS ON UNION'S LONG-TERM TRANSACTIONS

Margins on both Union's short-term storage transactions and its long-term deals historically have been shared with ratepayers in essentially the same way. Although the Board has devoted considerable time to long-term contracting issues in past Union cases, it has not determined that margins on the two types of transactions should be shared on fundamentally different bases. In its decision on Union's 2000 rates (RP-1999-0017), the Board described the rationale for sharing the margins on all of Union's storage sales:

> The Board recognizes that the assets necessary to provide both transactional services and long-term storage services have been paid for by Union's customers. Providing that the Company has a financial incentive to maximize revenues for these services should increase the benefits to both the customer and the shareholder. Consequently the Board authorizes a sharing of net revenues for transactional services and market premium for a long-term storage services in the ratio of 75:25 between ratepayer and shareholder as an incentive to maximize the revenue associated with both these services. [Paragraph 2.505]

Union's rationale for the sharing of storage margins has changed over time. In 1996, when it was unsuccessful in obtaining Board approval for long-term storage sales at market-based rates, Union had submitted that all of the margins would be credited to ratepayers "since in-franchise customers had paid for the development of the storage." In Union's 2000 rates case (RP-1999-0017), the Board noted that "Union's position was that ratepayers have paid for the services from the assets, not for the assets themselves." This is the position that Union advanced in this proceeding.

IGUA/APMCO claimed Union is estopped from changing its position on margin sharing. The argument is that the Board was persuaded to allow market-based rates on the condition that the bulk of the proceeds would go to the ratepayer. Accordingly, IGUA/AMPCO argued that it is now improper for Union to change its mind and to argue that these proceeds now need to go to the shareholder in order to promote the development of new storage.

Board Findings

The Board has determined that storage space in excess of the amount made available at cost-based rates (which is to be capped at 100 PJ – see Chapter 6) can be considered a "non-utility" asset. This is the space that will support Union's long-term storage sales. The Board finds that profits from new long-term transactions should accrue entirely to Union, not to ratepayers.

In comparing this decision with the past Board decisions on the sharing of margins on long-term storage sales, it is important to remember the context in which the Board made its earlier decisions. Until this proceeding, the Board had never reviewed the state of competition in storage and had not considered whether to refrain, in whole or in part, from regulating storage prices. Thus, there was little basis for the Board to treat the margins on short-term and long-term sales differently. Further, the Board's decision in RP-1999-0017 to allow all then existing cost-based contracts with ex-franchise customers to be renewed at market rates has resulted in a substantial growth in long-term margins, margins that have been largely for the benefit of ratepayers. It is certainly not possible today to assert that ratepayers have "paid for" the space that underpins Union's long-term storage contracts.

The Board does not accept IGUA/AMPCO's estoppel argument. Estoppel as a principle of contract law is sometimes called "detrimental reliance". IGUA/AMPCO's theory seems to be that when the Board made its decision on the sharing of long-term margins it relied upon an undertaking by Union to continue the sharing. Perhaps that might have been part of the Board's rationale at the time but the Board itself has now questioned the continuing need for the practice and whether the rationale developed at that time continues to exist.

This after all, is the purpose of section 29. Section 29 requires the Board to re-examine the need for regulation or the degree of regulation where market structures have changed. This Board in the Natural Gas Forum Report recognized that market conditions in energy markets have in fact changed. When such changes occur, regulators, particularly those such as the Board and the CRTC with statutory forbearance mandates in their governing legislation, must re-examine the regulatory construct in light of the current market conditions. That is what this proceeding seeks to accomplish. The concept of estoppel has no meaning in such a framework.

7.3 TRANSITION RELATED TO LONG-TERM MARGINS

IGUA/AMPCO and LPMA/WGSPG argued that in the event the Board decides to eliminate the sharing of any margins with ratepayers there should be some mitigation. As a precedent, LPMA/WGSPG referred to the 2003 decision by the Board on the phase-out of the Delivery Commitment Credit (DCC). There the Board recommended a five-year period based on a cost increase of 11.3 cents per GJ on a specific class of customers. LPMA/WGSPG argued that the phase-in period in the current case should be eight years, because the cost impact is a greater impact of 17.5 cents per GJ across all customer classes.

Board Findings

The Board recognizes that, particularly in recent years, Union's ratepayers have had a significant benefit due to sharing the bulk of the margins on long-term deals. The Board would prefer to have a smooth transition away from the status quo rather than an abrupt change in rates.

The Board finds, however, that there is no basis for retaining a requirement that Union share the margins on <u>new</u> long-term storage transactions, that is, long-term deals executed after the Board's forbearance decision. To continue sharing those margins with ratepayers would conflict with the Board's decisions (a) to recognize that part of Union's storage capacity constitutes a non-utility asset, and (b) to forbear from regulating the prices of ex-franchise transactions. Union should reap the benefits and bear the risks of those new transactions.

The margins that will be recorded in future years in respect of existing long-term deals are different. Those margins flow from long-term contracts that were negotiated and priced prior to the Board's forbearance decision and prior to the Board's decision that there is a non-utility part of Union's storage facilities. When those contracts were signed, Union had no reason to expect that it would receive anything more than 10% of the margin. The Board has concluded that ratepayers should continue to receive some of the margin on those existing contracts.

The Board considered whether to require Union to record the margins on existing long-term contracts separately from the margins on new long-term contracts. Under this approach, ratepayers would be credited with 90% of the margins on existing contracts for the remaining terms of those contracts. This approach conceptually has appeal but could give rise to ongoing implementation questions. For example, the Board might have to consider how contract re-negotiations or defaults by customers are to be treated. This level of complexity and potential ongoing review is unwarranted.

The Board has concluded that it should adopt a simpler phase-out mechanism that is a rough sort of "proxy" for the conceptual approach described above. The phase-out of the sharing of margins on Union's long-term storage transactions will take place over four years. The share accruing to Union will increase over that period to recognize that contracts will mature and a larger part of Union's total long-term margins will be generated by new transactions. For 2007, forecast margins (on long-term and short-term transactions) now included in the determination of Union's rates will remain unchanged. After 2007, Union's share of long-term margins will be as follows: 2008 – 25%, 2009 – 50%, 2010 – 75%, 2011 and thereafter – 100%.

The Board is currently undertaking a process to determine a multi-year incentive ratemaking framework for Union and Enbridge. That process will address how best to implement the Board's findings on the transition for long-term storage transaction margins within an incentive ratemaking framework.

7.4 ATCO DECISION

During the oral hearing and in final argument, several parties referred to the recent Supreme Court of Canada decision on the proceeds of an asset sale by ATCO Gas and Pipelines Ltd. Some parties claimed the case supported a cessation of margin sharing

9. CUSTOMER IMPACTS AND IMPLEMENTATION OF BOARD DECISIONS

9.1 CUSTOMER IMPACTS

The Board's decisions in this proceeding will affect the future gas bills of all distribution customers of Union and Enbridge in some fashion over the next few years.

9.1.1 Enbridge

Union storage contracts

Amending the existing storage contracts with Union to include cost-based pricing will have no effect on customers' bills. Enbridge has not yet started to pass through the current higher contract prices to customers so the Board's decision preserves the status quo. When those contracts mature over the period 2008 to 2010, Enbridge will likely procure the needed storage, which is about 18% of what Enbridge currently requires to serve its customers, at market prices. Those prices will depend on market conditions at the time and cannot be predicted. It is likely, however, they will be higher than the cost-based rates Enbridge charges for storage services from its own storage facilities.

Reducing Enbridge's share of the storage-related margins from its Transactional Services business

This reduction, from 25% to 10%, will reduce consumers' bills in the future compared to the status quo. The impact will depend on the amount of margins Enbridge is able to earn, which will depend on future market prices. Based on the level of margins earned by Enbridge in recent years, the impact of this change on a customer's bill is likely to be modest.

9.1.2 Union

Enbridge storage contracts

Amending these contracts to include cost-based pricing will reduce the amount of long-term storage margins Union will earn over the period until the contracts mature (2008 to 2010) and will therefore reduce the share of the margin flowing to ratepayers.

Changing the sharing of short-term storage revenues

The Board has decided that Union should be credited with the portion of short-term storage margins that are deemed to use the "non-utility" space at Union's storage facilities. Union's share of the margin will also include an incentive related to the utility portion of Union's storage assets. Based on the current level of short-term storage margins, this change will result in a small reduction in the margins that are for the benefit of ratepayers.

Phase-out of sharing long-term storage margins

This is the most significant change for Union ratepayers, who currently are credited with 90% of Union's long-term margins. Starting in 2008, the ratepayer share of these margins will decline each year and reach zero by 2011.

9.1.3 Overall Impact

The Board's decisions on the sharing of premiums on storage transactions will have virtually no effect on consumers' bills in 2007. The impact after that cannot be precisely quantified because it will depend on future market prices of storage and the level of margins earned by the utilities on ex-franchise storage sales. The impact on any individual consumer will also depend on the amount of gas they consume in the future.

The total annual gas bill for a typical residential consumer in Enbridge's territory (Rate 1) and in Union's Southwestern Ontario operations area (Rate M2) is in the range of $1,000 to $1,500 depending on the price of natural gas during the year. Assuming (a) that Union and Enbridge are able to earn the same amount on ex-franchise storage sales in the period 2008 through 2010 that they are forecast to earn in 2007, and (b) that gas prices and other delivery charges remain the same, the Board's decisions in this proceeding are likely to increase rates by a small amount – perhaps around 1% on the typical residential consumer's bill by 2011.

9.2 COMPLETION OF THE PROCEEDINGS AND COST AWARDS

As part of this proceeding, new unbundled rates have been approved for Enbridge and they are to be implemented as soon as possible. The Board therefore directs Enbridge to file a draft Rate Order within 15 days of this decision. The draft Rate Order should reflect the findings in this decision.

The Board also directs Union to file a Draft Rate Order reflecting the findings in this decision within 90 days. This should be done in conjunction with Union's filing of amended contracts with Enbridge.

The Board will issue a cost awards decision separately.

TAB 7

Ontario Energy Board

Commission de l'Énergie de l'Ontario

Ontario

EB-2005-0520

IN THE MATTER OF the *Ontario Energy Board Act 1998*, S.O. 1998, c.15, (Schedule B);

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing January 1, 2007.

BEFORE: Pamela Nowina
Vice Chair, Presiding Member

Paul Sommerville
Member

Ken Quesnelle
Member

DECISION AND FINAL RATE ORDER

Union Gas Limited ("Union") filed an application with the Ontario Energy Board on December 15, 2005 under section 36 of the Ontario Energy Board Act, S.O. 1998 c. 15, Schedule B. The Application was for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, storage and transmission of gas effective January 1, 2007. The Board assigned file number EB-2005-0520 to the Application.

The Board held a hearing and issued its Decision with Reasons on June 29, 2006. In its decision, the Board noted that there were other proceedings currently before other panels of the Board that would, or may, affect the final 2007 rates prior to their expected date of implementation on January 1, 2007. Among these were the Board's Demand-Side Management (DSM) Generic Proceeding and the Natural Gas-Electricity Interface Review (NGEIR). The Board issued its decisions on DSM and NGEIR on August 25, 2006 and November 7, 2006 respectively. The matters arising from each of those proceedings having rate consequences for Union are captured in this Rate Order.

Union provided its Draft Rate Order and supporting documentation to the Board and all intervenors in the three proceedings; rates, NGEIR and DSM, on November 23, 2006. The Board issued a letter on November 29, 2006 outlining a process for submissions from parties and reply from Union. The Board issued another letter to all parties on December 1, 2006, the subject of which was the Board's notice of intention to proceed with a new interest rate methodology effective January 1, 2007. The Board received five (5) submissions within its specified deadline for the receipt of submissions of December 5, 2006. Union's response to the submissions was filed on December 8, 2006.

The concerns expressed in the submissions can be categorized as follows: requests for clarification of the derivation of amounts to be included in rates; concerns about wording in the Draft Rate Order; concerns about the correct interpretation of the NGEIR Decision; and concerns about appropriate back-up for the calculations included in the Draft Rate Order.

With respect to the requests for clarification of the derivation of amounts to be included in rates, the Board is satisfied that Union has provided the requested clarification.

With respect to the wording concerns, the Board agrees with the suggestion of LPMA / WGSPG with respect to paragraph 13 of the Draft Rate Order and will adopt such wording. The Board notes that Union was not opposed to the suggested change.

With respect to concerns about the correct interpretation of the NGEIR Decision, the Board notes that such concerns are centered on section 7.3 of that Decision at page 107. The sentence reads as follows:

> For 2007, forecast margins (on long-term and short-term transactions) now included in the determination of Union's rates will remain unchanged.

The concern is about whether that sentence means that there should be an adjustment to the amounts set out in section 2.4 of the EB-2005-0520 Settlement Agreement on the 2007 Storage and Transportation Revenue Forecast (S&T forecast).

The Board finds that the wording of section 2.4 of the Settlement Agreement clearly envisaged that there may be changes to the S&T forecast as a result of the NGEIR proceeding. The S&T forecast accepted in the Settlement Agreement included revenues associated with providing storage services to ex-franchise customers at market-based rates. The NGEIR Decision at page 65 is unequivocal in its direction on how Enbridge's 2007 storage rates with Union should be treated – i.e., that they be cost-based.

> Enbridge's rates in 2007 will continue to reflect cost-based storage rates for the services it acquires from Union.

The Board finds that Union's calculations for 2007 rates included in its Draft Rate Order reflect cost-based storage for the storage services it provides to Enbridge. Further, the Board finds that Union's inclusion of a 90% sharing of S&T forecast margin included in the 2007 rates is appropriate. The Board finds that the NGEIR Decision intended that margins continue to be shared on a 90:10 ratepayer to shareholder ratio for 2007. Union provided the calculations, and the supporting rationale, for the adjustment proposed to the S&T forecast in the EB-2005-0520 Settlement Agreement. The Settlement Agreement included numbers assuming market rates for storage. These numbers needed to be adjusted once the Board's' Decision in NGEIR was released. In the Board's view, Union's treatment is consistent with the NGEIR Decision.

With respect to the concerns about the appropriate back-up calculations for the Draft Rate Order, the Board finds that Union has provided such back-up calculations.

Having reviewed all of the materials, the Board considers it appropriate to proceed with its final rate order for Union.

THE BOARD THEREFORE ORDERS THAT:

1. The rate changes set out in Appendix "A" and the rate schedules set out in Appendix "B" are approved effective January 1, 2007. Union shall implement these rates on the first billing cycle on or after January 1, 2007.

2. The Monthly Charge for Rate M2 and Rate 01 shall increase from $14 to $16 effective January 1, 2007.

3. In accordance with the EB-2005-0520 Settlement Agreement (item 3.8 at p.17), EB-2005-0520 hearing costs shall be amortized over a two year period, 2007 and 2008. Hearing costs were forecast to be $4.6 million and the OEB cost assessment was forecast to be $3.7 million. No variance account has been established for either the hearing cost or the OEB cost assessment.

4. In accordance with the EB-2005-0520 Settlement Agreement (item 4.1 at p. 21) as approved by the Board, the return on equity (ROE) for 2007 has been calculated using the Board's ROE Guidelines updated to reflect the October 2006 Consensus forecast. The updated ROE for 2007 is 8.54%.

5. In accordance with the EB-2005-0520 Decision with Reasons, effective January 1, 2008, the current M2 rate class shall be split into two new classes which are M1 and M2. The new M1 rate class will be the small volume general service rate class for residential and non-contract commercial/industrial customers consuming 50,000 m^3 or less per year and the new M2 rate class will be the large volume general service rate class for customers consuming greater than 50,000 m^3 per year.

6. In accordance with the EB-2005-0520 Settlement Agreement (item 6.8 at p. 29) as approved by the Board, effective January 1, 2008 Union shall reflect the Gas Distribution Access Rule (GDAR) phase 2 compliance costs in rates. The requirement for $8.7 million in GDAR related capital and $138,000 in ongoing O&M expense translate to an additional $1.643 million in revenue requirement in 2008 at the updated ROE of 8.54%.

7. In accordance with the EB-2006-0021 Decision with Reasons on Demand Side Management, the 2007 budget for direct and indirect DSM costs shall be $17.0 million ($15.3 million for direct and $1.7 million for indirect costs), an increase of $11.3 million over the amount included in existing rates. This increase will be reflected in rates effective January 1, 2007. The DSM budget shall escalate by 10% annually to $18.7 million for 2008 and $20.6 million for 2009. These budget increases shall be reflected in rates effective January 1, 2008 and January 1, 2009 respectively.

8. In accordance with the EB-2006-0021 Decision with Reasons, Union's DSM target for 2007 is $188 million in TRC savings. The Shared Savings Mechanism ("SSM") at target for 2007 is $4.75 million.

9. In accordance with the EB-2005-0551 Decision with Reasons, the Board has ceased regulating ex-franchise storage services and new storage services. Other than for Enbridge Gas Distribution Inc. contracts LST045, LST046 and LST047, terms and conditions of service (including pricing, nominations and General Terms and Conditions) previously found on the C1 and M12 rate schedules can now be found under the "Market Price Storage Services" section of Union's website.

10. In accordance with the Board's EB-2005-0551 Decision with Reasons, the phase-out of cost based storage rates (and the transition to market-based pricing) for Enbridge Gas Distribution Inc. will begin in 2008 and be completed in 2010. As a result of the Board's EB-2005-0551 Decision, Enbridge will be provided with cost-based storage rates in 2007. This increases the 2007 revenue deficiency and associated rates by $8.16 million.

11. In accordance with the EB-2005-0551 Settlement Agreement (at p. 25-27) as approved by the Board, the revenue deficiency has been increased by $0.15 million to reflect the elimination of the M12 transportation premium. This increase will be reflected in rates effective January 1, 2007.

12. In accordance with the Board's EB-2005-0551 Decision with Reasons, the 2007 revenue deficiency and associated rates shall be increased by $4.067 million to reflect 10% of the forecast S&T transactional margins. This approach is consistent with Union's treatment of S&T Transactional margins reflected in current Board-approved rates.

13. In accordance with the Board's EB-2005-0551 Decision with Reasons, starting in 2008 the sharing of revenues on Union's short-term storage transactions less

any incremental costs incurred by Union to earn those revenues (i.e. margin) will be shared by Union and ratepayers in proportion to the allocation of rate base between utility and non-utility assets. The allocation is currently 79% utility and 21% non-utility. Union will receive 10% of the margin deemed to be earned from utility assets and 100% of the margin deemed to be earned from non-utility assets.

14. In accordance with the Board's EB-2005-0551 Decision with Reasons, the phase-out of the sharing of margins on Union's long-term storage transactions will take place over four years. After 2007, Union's share of long-term margins will be as follows: 2008 – 25%, 2009 – 50%, 2010 – 75%, 2011 and thereafter – 100%. This phase-out will be reflected in future rates beginning in 2008.

15. The rates pursuant to all contracts for interruptible service under Rates M5A, M7, T1, R16 and R25 shall be adjusted effective January 1, 2007 by the amounts set out in Appendix "C". Union shall implement 2007 changes in rates on the first billing cycle after January 1, 2007.

16. The customer notices in Appendix "D" shall be given to all customers with the first bill or invoice reflecting the new rate.

17. Union shall charge the fees as set out in Appendix "E" for non-energy charges.

18. Union shall close the following deferral accounts effective January 1, 2007:

179-56	Comprehensive Customer Information Program
179-60	Direct Purchase Revenues and Payments
179-110	Storage Rights Compensation Costs
179-114	Incremental OEB Cost Assessment

19. Union shall maintain the following deferral accounts in accordance with Appendix "F".

179-26	Deferred Customer Rebates/Charges
179-69	Transportation & Exchange Services
179-70	Short-term Storage and Other Balancing Services
179-72	Long-term Peak Storage Services
179-73	Other S&T Services
179-74	Other Direct Purchase Services
179-75	Lost Revenue Adjustment Mechanism
179-89	Heating Value
179-100	TCPL Tolls and Fuel – Northern and Eastern Operations Area
179-102	Intra-Period WACOG Changes
179-103	Unbundled Services Unauthorized Storage Overrun
179-105	North Purchase Gas Variance Account
179-106	South Purchase Gas Variance Account
179-107	Spot Gas Variance Account
179-108	Unabsorbed Demand Cost (UDC) Variance Account

179-109	Inventory Revaluation Account
179-111	Demand Side Management Variance Account
179-112	Gas Distribution Access Rule ("GDAR") Costs
179-113	Late Payment Penalty Litigation
179-115	Shared Savings Mechanism
179-116	Interest on the Gain on the 2004 Cushion Gas Disposition

20. In accordance with the EB-2006-0021 Decision with Reasons, the accounting order for the Demand Side Management Variance Account (No. 179-111) shall be amended to reflect its continuation until it is changed or eliminated. This accounting order shall be further amended to identify that if actual direct DSM expenditures exceed the DSM budget approved for recovery in rates, the variance to be recovered by Union shall be up to a maximum amount of 15% of the approved direct DSM expenditure budget.

21. In accordance with the EB-2006-0021 Decision, Union shall establish the Carbon Dioxide Offset Credits Deferral Account (No. 179-117) to record the amounts representing proceeds from the sale of or other dealings in carbon dioxide offset credits earned as a result of Union's DSM activities.

22. Any party eligible for an award of costs must file a claim with the Board and Union no later than January 5, 2007. Should Union have any comments concerning any of the claims, these concerns shall be forwarded to the Board and to the claimant by January 10, 2007. Any response to Union's comments must be filed with the Board and Union by January 12, 2007.

23. Union shall pay the costs of eligible intervenors upon receipt of the Board's costs order.

DATED at Toronto, December 19, 2006.

ONTARIO ENERGY BOARD

Original signed by

Peter H. O'Dell
Assistant Board Secretary

UNION GAS LIMITED

Accounting Entries for
Long-Term Peak Storage Services
Deferral Account No. 179-72

Account numbers are from the Uniform System of Accounts for Gas Utilities, Class A prescribed under the Ontario Energy Board Act.

Debit	-	Account No. 570 Storage and Transportation Revenue
Credit	-	Account No. 179-72 Other Deferred Charges - Long-Term Peak Storage Services

To record, as a credit (debit) in Deferral Account No. 179-72, the difference between actual net revenues for Long-Term Peak Storage Services including C1 Firm Peak Storage and the net revenues forecast for these services as approved by the Board for rate making purposes.

Debit	-	Account No. 179-72 Other Deferred Charges - Long-Term Peak Storage Services
Credit	-	Account No. 323 Other Interest Expense

To record, as a debit (credit) in Deferral Account No. 179-72 interest on the balance in Deferral Account No. 179-72. Simple interest will be computed monthly upon finalization of the year end balance in the said account in accordance with the methodology approved by the Board in EB-2006-0117.

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Ontario

For immediate release

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OEB Issues Decision with Reasons in the Union 2007 Rates Case

Toronto – Today the Ontario Energy Board (OEB) issued a Decision with Reasons pertaining to Union Gas Limited's (Union) application for approval of delivery rates for its 2007 fiscal year.

The proceeding included a settlement process whereby Union and the other parties reached settlement on a majority of the issues. The remaining unsettled issues were heard by the Board in an oral hearing.

One of the unsettled issues was Union's Gas Cost Risk Management Program. The Board has allowed Union to continue to operate this program on the basis that it is effective in reducing price volatility and the program is modest in terms of its costs of operation.

With respect to Union's request for pre-approval of its proposal for a 24-month fixed cost purchase plan, the Board did not pre-approve this arrangement because the proposal already falls within the scope of Union's Gas Cost Risk Management Program.

Among the other unsettled issues the Board approved in the Decision, was Union's proposal to split the M2 class into two new general service rate classes – a small volume general service rate class for residential and non-contract commercial/industrial customers consuming 50,000 m^3 or less per year (M1) and a large volume general service class for customers consuming more than 50,000 m^3 per year (M2). The Board also approved Union's proposal to increase the monthly fixed rate from $14 to $16 per month effective January 1, 2007, noting the proposed increase to the fixed monthly charge is based on a straight-forward cost allocation element of rate design and is therefore appropriate.

The Board expects to issue a rate order reflecting this Decision prior to the start of the new rate year, which takes effect on January 1, 2007, however several matters currently before the Board, including the Board's Demand-Side Management Generic Proceeding and the Natural Gas-Electricity Interface Review, may affect the final 2007 rates prior to their implementation. The impact on consumers will be determined after these proceedings have concluded and rate schedules have been received.

For more details and other topics considered in the Decision, please refer to the Decision which can be found on the Board's web-site at www.oeb.gov.on.ca.

The Ontario Energy Board regulates the province's electricity and natural gas sectors in the public interest. It envisions a healthy and efficient energy sector with informed consumers, and works towards this vision through regulatory processes that are effective, fair and transparent.

For more information on the Board, please visit our Web site at www.oeb.gov.on.ca or contact the Consumer Relations Centre at 416-314-2455 or toll-free at 1-877-632-2727.

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